Cotton Future Contract Trading

AND

Adverse Legislation

Editorials From the "Union Guide"

OF

Houston, Texas.

1911-12

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Gift
E. A. Colvin
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The question of Future Contract Trading has been agitated with more or less prejudice and violence during the past several years, and a great deal of misinformation concerning the same has been exploited. Realizing the importance of a sane and correct solution of the problem, not only to the producer of cotton but to the cotton trade of the South, I have made a study thereof and have published my conclusions in a series of editorial articles in the Union Guide. These articles have attracted the attention of a good many people who are earnestly in favor of improving the conditions that maintain in the great cotton industry, and in response to numerous requests from these, I have re-published these articles in the present form. It is my earnest hope that these editorials will to some extent serve to bring about a better understanding of a subject of vital importance to the people of the South.

E. A. CALVIN.

CHAPTER I.

Cotton Exchanges and Prohibitory Legislation.

The threatened passage of the Scott Anti-Cotton-Future Bill at the last session of Congress aroused so vigorous a protest from the bankers, business men and many farmers of the South, that the advocates of drastic legislation along these lines may well pause in order to give more mature consideration to so radical and far-reaching a measure.

It is not only advisable that the members of Congress should look further into the effects of such legislation before committing their constituents to the trial of a possibly disastrous experiment, but these constituents themselves, and especially the farmers—they being most directly and to the greatest extent affected thereby—should demand that measures affecting their welfare be based upon intelligent and public spirited investigation and conclusions, and not upon demagogic appeals to prejudice.

Economic laws are like the laws of nature—if indeed they are not the laws of nature. They are unchangeable and inexorable and the man or the community or the nation which undertakes to nullify these laws, or to interfere with the operation thereof, or to run counter thereto, will be broken as a twig in the hand of a giant. The old Dane who undertook to stay the incoming progress of the tide by virtue of his royal command, was not more preposterous and futile than is the latter-day legislator, who makes a demonstration in Congress for the repeal of the law of cause and effect.

The late Scott Bill and similar legislation pending, represents not only an attempt to try an experiment in legislation upon one class of citizens alone and upon one section of our country only, but is the concrete expression of a reckless desire to meddle with the complex machinery of a great trade system, upon the unhampered operation of which depends the welfare of many millions of people.

It is not to be denied that the operation of the trade system by which the cotton crop is moved from the fields and distributed to the four corners of the earth, is afflicted with some drawbacks, some imperfections and some abuses. But this is true of all trade systems and of all human enterprises, undertakings and developments. These distempers of the body economic have been and will be seized upon by the seeker after notoriety, emolument or power, as the means whereby popular prejudice may be set ablaze and he, by the light of it, see the way to the goal of his desires. But the true leader, the patriotic citizen and the public-spirited press should approach these problems from another standpoint. The aim of such teachers and workers should be first, to investigate and study the problems in order that the truth may be known, and then to direct their efforts to the end that the good may be appropriated, preserved and expanded, and the evils eliminated and destroyed.

Approaching the Cotton Exchange and Future Trading problem in this spirit, we should primarily advise ourselves definitely and accurately as to the nature and functions of the Cotton Exchange and of Future Trading; then we should examine into the part that these institutions and this trade system play in the modern methods of marketing and distributing the cotton crop; then we should study the advantages and benefits derived from the operation of the agencies in question; and then we should inquire into the evils complained of, the nature and source thereof; and finally, we should, in the light of the information obtained, address our efforts towards

such regulation, restriction, prohibition and encouragement, as would on the one hand eliminate all that is objectionable and injurious, and on the other preserve and strengthen all that operates for the interest of the great cotton industry and for the advantage of the producers of the great trade asset of the South.

Following the foregoing outline we propose in the first article to discuss the legitimate Cotton Exchange, what it is and what it is not; and what the results upon the cotton producer and the cotton trade would be if its functions were suspended by legislative prohibition.

COTTON EXCHANGE AND BUCKET SHOP DIFFERENTIATED.

In the agitation that a few years ago swept the country, the terms "Bucket Shop" and "Cotton Exchange" were used indiscriminately as if—and indeed as was concluded by many—they meant the same thing. At the time in question a very real evil was in existence throughout the South, and very reprehensible conditions prevailed. Speculation was then rampant, not only in the Southern States, but throughout the entire country as well. Men who desired to profit by this mania for speculation established offices or so-called "Cotton Exchanges" in a multitude of towns both large and small throughout all the South. These people made it possible for men of small means, clerks, and even women and children to speculate or gamble, as they untruthfully announced, "in *cotton*." These offices were not Cotton Exchanges, but Bucket Shops, and the speculators in these offices were not trading in cotton or in cotton contracts, but were simply betting with the proprietor upon the fluctuations in price that occurred in the cotton market. It is important that the distinction between a Cotton Exchange and a Bucket Shop should be clearly understood. In a legitimate Cotton Exchange binding and enforceable *contracts* are made for present

and future delivery of cotton, and the prices at which such cotton is bought and sold, both for present and future delivery, are posted upon the blackboards of the Exchange and telegraphed throughout the world so that all who are interested may know what traders are paying for cotton and, consequently, be apprised of the value thereof. In a Bucket Shop no contracts whatever are made. Nobody buys any cotton or sells any. The proprietor of the Bucket Shop, for the purpose of masking his game, adopts the nomenclature of the legitimate exchange and of the actual cotton trade. But in fact all he does is to bet his victims that the price of cotton, as registered by actual contracts and trades in the Cotton Exchange will go up or down, as the case may be; and all the victims of the bucket shopper do, is to take the other end of the bet. The Cotton Exchange, if fairly and equitably conducted, is no more to be condemned and destroyed because of the practice of bucket-shopping, than is the ocean liner to be condemned and prohibited from crossing the seas because some individuals see fit to bet with each other on the speed at which the vessel will travel.

But, as has been said, the terms "Cotton Exchange" and "Bucket Shop" were used indiscriminately, with the result that to the many who did not understand the difference, the actual evil which they observed proceeded from the Bucket Shop in their town, was inaccurately attributed, and denunciation thereof applied, to the Cotton Exchanges in the great markets of the world. Thus the Cotton Exchanges, no matter what their faults may be, have been through inaccurate and unthinking generalization, accused and condemned for faults in no just sense attributable to them, and for evil practices which the Exchanges have done their very best to destroy.

THE LEGITIMATE COTTON EXCHANGE.

The legitimate Cotton Exchange is a place where buyers and sellers are brought together and trading conducted at less expense,

with more facility, and in greater volume than could be done if the traders were separated; it is an organization which establishes communication with the other markets, both foreign and domestic, and collects information as to values and conditions, and statistics and reports as to the progress of the crop, the state of the dry goods trade, and the amount of cotton taken by spinners; it frames rules for the government of its members and the trading between them, among themselves, and with non-members; and finally it establishes tribunals before which disputes may be settled and punishment inflicted upon offenders against honorable conduct in business.

Originally the trading in the Cotton Exchanges was limited to "Spot" transactions, i. e., to the purchase and sale of cotton actually in hand. But as production increased and consumption grew, it was found that a need existed for trading in future contracts, or in other words, for buying and selling cotton for delivery at some time in the future. In order that such trading should be conducted with satisfaction and efficiency, the Exchanges in which such trading prevailed, adopted a form of binding contract which must be signed by the parties thereto, and formulated rules governing the conduct of the business.

In the course of time there came into the markets a class of traders who, although they did not manufacture cotton goods themselves, were willing to buy cotton when they thought the price was too low, in order that they might sell later at a profit. These traders, therefore, competed with the spinners. They not only bought and sold cotton for present delivery, but also bought and sold contracts for future delivery. The supply of contracts furnished by these traders, as well as by those who had cotton which they wished to sell, and by spinners who wished to buy to fill future consumptive needs, constituted what is known as the Future Market, and made possible the very important facility of "hedging."

The prices for future delivery made by trades in future contracts represent the consensus of opinion of the traders as to the probable value of cotton at such future time. If the Future Market is in the producers' country where the great majority of men hope that cotton will advance in value and are by this hope influenced in their opinion, then the prevaling future prices in such market will be relatively high. If, on the contrary, the Future Market is located in the spinners' country where most men hope that cotton will go down and, consequently, believe that it will do so, then the prevaling future prices in such market will be relatively low. In order that the trade may be advised of present conditions and be able to form some opinion as to prices in the future, the Exchanges at a large expense collect reliable data covering all the conditions both of crop and trade, that go to make prices. This information so gathered, is by the Exchange disseminated throughout the country, with the result that every day and at all times during the day the farmer or the merchant, even in the small towns of the country, know what cotton is worth in all the markets, are apprised of conditions which would likely affect prices, and hence cannot be misled or duped by intending buyers, into selling cotton for less than its value.

The laws of the several Southern States have practically eliminated the evil of bucket shopping heretofore referred to. But now the effort is made in Congress not only to prevent betting on the fluctuations in the price of future contracts, but to prohibit the *making of future contracts;* not only to close up the Bucket Shops, but to destroy the legitimate Exchanges as well. We will hereafter discuss more in detail the benefits derived by the farmer and all legitimate interests through the agency of future trading *per se,* and the loss that would be occasioned if such trading were prohibited. Here we will call attention to the most obvious ill results that would follow the enactment of a law directed against the legitimate American Exchange:

1st. If the American Future Exchange was closed, then there would remain only the Liverpool and Continental Exchanges in operation. These exchanges are Spinners' exchanges. No cotton is produced in those countries, but there are many mills. The spinner desires to buy cotton as cheaply as possible, and in any future market dominated by the spinner and his friends the prices would naturally and inevitably be forced down as low as possible. With no resistance on the part of the producer and his friends, the contest would be one-sided and unequal, and hence the price-making power would be surrendered to foreign interests, and the farmer would have to sell at the low prices fixed by the spinners in Liverpool, Bremen and Hàvre.

2nd. If the American Future Exchange was closed then all the information as to the price of cotton in all the markets of the world and all the information as to conditions which go to make up the price and the price outlook, would be no longer disseminated. The buyer and spinner would know what the Liverpool Exchange and the other foreign exchanges were doing, but the farmer and the merchant, especially in the small towns, would be in the dark. Thus the producer would be at the mercy of the buyer, and all the American cotton trade would be at the mercy of the foreign spinning interests which would be intent upon buying cotton as cheaply as possible.

These preliminary considerations are commended to the serious thought of the farmer and of all those who are his friends. Before supporting any anti-future bill, those interested should be very sure that the measure would not produce the results outlined above. Some legislation is necessary in order that the operations of the exchanges should be equitably regulated, but this question, like all others of legislative agency, should be handled with discretion and discrimination.

CHAPTER II.

Anti-Option Legislation.

Extreme legislation as a general thing is like a two-edged sword—it cuts both ways. Legislation not always extreme often acts in the same manner if not given proper consideration. The tariff question for example: Free trade is ideal. To be enabled to buy in the cheapest market and sell in the dearest without let or hindrance, is the sum and substance of free trade. We want free bagging and ties for baling cotton, because the tariff on these is a burden to the cotton producer and helps the bagging and steel trusts, but we do not want free foreign raw cotton, because the Egyptian cotton grown by cheap labor comes in direct competition with our long staple, and its encouragement cuts profits on the home product; and so on along the line. We are free traders in theory, because the theory is ideal, but like all other things good on their face, it is subject to numerous exceptions.

And so it is with legislation; what on its face may seem good and fit, may prove on application not unmixed with evil.

Not a few among our best thinkers among the farmers have believed the only way to abate the evils that have fastened upon the cotton trade is to abolish the Exchanges. To prevent the making of contracts for the purchase or sale of cotton for future delivery, unless coupled with conditions practically prohibitive.

This is what the so-called Scott Bill proposes.

But are there not two sides to this matter? No one questions the sincerity of the advocates of the Scott Bill; but would the measure, if adopted, accomplish the ends sought? Would it abolish futures? It would in the great Exchanges of New Orleans and New York as far as interstate commerce in the United States is concerned. It would drive away millions upon millions of dollars of

American capital which now help us to move our crops and obtain cash money for them with the same facility and promptness that one with money in bank can cash a check. But how about Liverpool and Havre and Bremen? They would go on the same as ever, only, with our American Exchanges crippled and unable to put up a fight in behalf of American cotton, the foreigners might dictate prices. Is it to be supposed that they, the representatives of the foreign spinners, would work in favor of the American farmer? Would they pay any more for our cotton than they could help? Past history does not show it. How about the future? Would the leopard change his spots? They would try to buy their raw cotton as low as possible and sell their manufactured goods as high as possible. The British lion makes a handsome picture as far as lions go, but it is safest to keep American heads out of his mouth. France and Germany are our good friends in the way of trade for what they can make out of us. Germany tried prohibition of futures, but has changed her law and Bremen is about commencing the Future business again. Bremen has already made enough on arbitrating American cotton to build the handsomest Exchange in the world. Is it so sure that we need such a radical change as the Scott Bill would force? Do our farmers want to be brought face to face with the spinners, with none to intervene between them? We market in the first six months of the year nearly twice as much cotton as the spinners need in the same time. Who then is to take or carry the surplus when the mills buy only as they need the cotton, if we drive away the capital which has been performing that service?

The capitalist or speculator will not consent to carry cotton unless he is able to hedge against a possible decline. The average buyer in the country will not buy our cotton unless at a wide margin and even at that he will hesitate if there are no American future markets in which he can hedge. The small buyer who now competes for our cotton in country towns will be driven out altogether.

One has only to go over the newspaper files before the establishment of futures, to show what would be in store for us if we return to old conditions. These are matters which require serious consideration at the hands of farmers.

Look at the record this and last year: Last year we got for our cotton crop including the seed, $902,000,000. This year we will receive more than one thousand millions of dollars for the crop, including the seed. The calculation is easy. Already up to the close of March we had sold $818,000,000 and the remnant of the crop which is selling at an average of $75 per bale and over will bring $84,000,000. Add to this $125,000,000 for the seed and we have a total of one billion and twenty-seven millions.

No two crops big or little ever brought near such amounts.

And yet all the time throughout these two remarkable years the mills have been crying bad trade, short time. These results have been obtained under a system of trade, including futures. Would that have been the case had the middleman who carried the surplus been unable to hedge his purchases? Would he have been able to say to the mills "the cotton is worth the money and if you don't buy it at the price I will, and will make you pay more when you are forced to buy?"

Suppose these men who took the chances had been driven out by law, would we have obtained nearly two thousand millions of dollars for the two crops? That is a more than serious question. Some of the advocates of the Scott Bill claim we would have gotten more. But how? The spinners have not paid us one cent more than they were forced to. If they could have had their own way, they would have paid ten to twenty dollars a bale less. Take the records of the past ten years and we will find that $45 to $55 per bale has not been an unusual price for cotton. What would such figures have meant compared with $75 and over for the two years just ending. Anywheres from four hundred millions to seven hundred millions of dollars.

We do not say that such would have been the case, but it is not beyond the bounds of possibility. Would it have been conservative to take the risk?

We do know that if existing business methods are disrupted the result, for a time at least will be chaos, and while a new order is being established who will pay the losses? Do not all costs incident to marketing come out of the cotton itself?

While the future system has been in force the trusts with all their billions of money have not dared to interfere with cotton. They have tackled Sugar and Iron and Bagging and Lumber and Oil and other commodities which have no futures. In cotton every man who considers cotton is cheap has an opportunity to buy through the future market and the combined means of the many, offsets even the great assets of the trusts. Even the Rothschilds have always steered clear of cotton.

Would it not, therefore, be wise to exercise some conservatism in dealing with this important matter?

If the institution of futures is of benefit we should conserve the good in it. What is bad should be eliminated, but in the elimination that which is of benefit should not be destroyed.

Bucket Shops should be prohibited throughout the United States; they are only bettors on the price of cotton as established in the Exchanges. No contract should be permitted that does not give to the buyer the legal right to demand the cotton and none that does not give to the seller the right to deliver the actual cotton, and no contract should be permitted that is not settled upon the actual prices which prevail from day to day for the grades of cotton specified therein. No contract should be permitted which specifies that differences between the different grades shall be arbitrarily fixed for months upon months regardless of the actual market prices therefor.

The banks are under government supervision, why not cotton? Why not try supervision instead of abolition?

The United States government has through its Bureau of

Corporations completed perhaps one of the most exhaustive investigations of the Exchanges and the Cotton Future Business that has ever been made in relation to trade matters. The report of Commissioner Herbert Knox Smith embraced every phase of future contracts, their advantages and the correctives needed to bring the system into line with the interests of the grower of cotton.

A measure in keeping with Commissioner Smith's recommendations is well worthy of trial. This with Government supervision to enforce the law in letter as well as in spirit, it is claimed, will remove objections now urged while retaining its advantages as an adjunct to the marketing and sale of the cotton crop.

Would not that be a better plan than risking a radical experiment, the result of which may or may not prove doubtful?

CHAPTER III.

Nature of the Future Contract; and Method of Trading.

Having in a former issue discussed the functions of a legitimate Cotton Exchange with particular reference to future contract trading; and having differentiated such an Exchange from the nefarious institutions designated as Bucket Shops, and distinguished the future transactions conducted in the former from the gambling ventures undertaken in the latter; it is now in order to give some more particular attention to the nature of the future contract and the method of trading therein.

FUTURE CONTRACT A BINDING OBLIGATION.

Much misunderstanding has existed and much misinformation has been disseminated in regard to the contract for future delivery of cotton. It has been dogmatically affirmed by anti-future advocates that the future contract was a sham and a mere subterfuge invented for the purpose of giving apparent legitimacy to a purely gambling hazard. While it is true that there is and has been and must be speculation *in* future contracts, it is not true that the contract for future delivery under the rules of a legitimate Exchange is unreal or a delusion and a sham. On the contrary, such contract to deliver or to receive cotton at some specified time in the future, is a binding obligation specifically enforceable both under the rules of the Exchange and in the courts of law. If any one doubts the validity and reality of such contracts let him sell on the Exchange a hundred bales of cotton to be delivered in some future month, or let him buy for reception at some future time, and if he does not, before the maturity of the contract, dispose of the same or transfer his obligation to some one else, he will find that he must deliver or receive, as the case may be, or else pay the same penalty he would

pay in the case of a breach of any other contract. And furthermore, not only is such future contract enforceable, but it is also secured; each party being required to put up collateral sufficient to protect the other party from loss in the event that the one party or the other fails to specifically receive or deliver according to the obligation in the contract.

EXECUTION AND TRANSFER OF CONTRACTS.

Briefly the form of the future contract and the methods of trading therein is as follows: A, who is a principal, gives an order to B, who is a broker, to buy say 100 bales of cotton to be delivered in October. Y, who is a principal, gives an order to X, who is a broker, to sell, say, 100 bales of cotton for October delivery. B, the broker, bids a price per pound, basis middling, for the said 100 bales. X, the other broker, accepts the bid and sells for the delivery stipulated and at the middling basis price agreed. B and X, the brokers, thereupon enter into a binding contract in the form prescribed by the Exchange whereby the one agrees to receive and the other to deliver the actual cotton covered thereby, at the time and at the price stated, and furthermore each is required to give to the other security that the contract will be carried out according to the terms thereof. A and Y, the principals in the premises, are responsible to B and X, who are acting as agents or brokers, and B and X are representing their principals A and Y. The contract is now made and signed and the obligation of all parties fixed and determined.

If the principals A and Y, give no further instructions in regard to the contract, when October comes, X, the broker, must deliver to B, the other broker, 100 bales as per contract and B must receive and pay for said cotton. In such case X delivers the cotton for account of his principal Y, and B, receives the same for account of his principal A. This is the simplest form of future contract trading.

But suppose that after the contract has been signed and entered

into by B and X, the brokers; A, the principal who has bought the 100 bales, decides that for some reason he does not want to take delivery in October. Perhaps he had bought the contract for the purpose of hedging a sale of some specific grade or some special kind of cotton which he had contracted to deliver to a spinner, not having said cotton in hand at the time: When, therefore, he had purchased the specialty, he would have no further need for the future contract. In such case he would tell B, his broker, to sell his contract, or in other words, to find some one who would take his place and assume the obligation to receive the cotton in October. C, an entirely new party, wants, at this time, to buy 100 bales for October delivery. He, therefore, through his broker, at a price assumes A's obligation as principal to the broker, B; the contract between B, the broker, and X, the other broker, remaining intact. In the same way, Y, the other principal in the original obligation, may desire to be relieved of his obligation to deliver the 100 bales in October, he having in the meantime disposed of the 100 bales of cotton in hand against which he had sold the contract as a hedge. He, therefore, tells his broker X, to get some one to take his, Y's, place and assume his obligation to deliver the cotton. W, another new party, desires at this time to hedge some cotton he has in hand, by selling the same for October delivery. He, therefore, through his broker, at a price, assumes the obligation of Y, the original principal in the premises. The contract between B and X, the brokers, remains intact and each is bound as firmly as ever, the one to receive and the other to deliver 100 bales in October, but the principals, to whom both brokers look for performance, are new. Thus the principals may change any number of times before the maturity of the contract, but when it does mature, it must be liquidated in accordance with the terms thereof. The two brokers are responsible to each other for this performance, but they discharge their obligation to each other for the account of their respective ultimate principals.

From the foregoing it will be seen that the future contract entered into under the rules of a properly organized and equitably regulated exchange, is not a nefarious or dishonest subterfuge but a definite and binding obligation: and furthermore, it will appear that these contracts having been once properly and validly issued, may be bought or sold or transferred in the course of trade, just as a promissory note, or other obligation, once issued, may be bought or sold or transferred for a consideration.

LARGE VOLUME OF TRADING LOGICAL AND NECESSARY.

When the modern trade methods of moving the crop are understood, no difficulty will be experienced in appreciating the fact that from the time the farmer parts with possession to the time when the cotton reaches the ultimate consumer, it passes through many different hands and is the subject of diverse and successive ownership. The same lot of cotton passes from the farmer to the merchant, and from the merchant to the buyer and from the buyer to the spinner or from the buyer to another buyer or exporter, and from such other buyer or exporters to still others until it reaches the spinners' hands and is spun into cloth, sold to the cloth merchant and finally to the man who wears the clothes made therefrom.

All of these intermediate owners are subject to the risk of ownership or of contract with reference thereto: *i. e.*, the risk of fluctuations in the price of the cotton during the time such cotton is in their possession pending disposition of the same, or before they can get possession of cotton with which to fill a spot contract previously made. These owners or contractors in spot cotton desire to protect themselves against the risk of such fluctuations, and in order to do so they send to the Exchange and sell or buy a future contract, or future contracts, for the purpose of hedging their specific grade transactions and contracts. This multitude of traders in the future markets engaged in the non-speculative effort of pro-

tecting themselves against price variations, necessarily inaugurate a multitude of trades and thus create a volume of transactions which to the uninformed observer appear to be out of proportion to the amount of cotton at the time actually in existence.

One of the principal and most insistent arguments of the opponents of future trading is drawn from this very fact that the volume of future transactions is largely in excess of the actual crop grown. They claim that legitimate future sales and purchases must be limited to the actual crop and that any over-plus of contract trading is necessarily fictitious and representative of speculative transactions.

APPARENT EXCESSIVE FUTURE TRADING EXPLAINED.

Having in mind the analysis of the future contract, and the method of trading therewith, heretofore given, it will not be difficult to account for this apparent excess and to explode the fallacy of the argument mentioned. It is desirable that the reader shall keep clearly in mind the distinction drawn, in a preceding section of this article, between the *making* of the future contract and the *buying and selling of the obligations imposed by such contract.*

In the first place each future purchase and sale made in the Exchange may not, and in fact every such purchase and sale does not, represent a new transaction, but a transfer to other parties of a contract already made. For instance, A and Y, in the original illustration may through their brokers enter into a contract for the purchase and sale of 100 bales of cotton for October delivery. Before the contract matures and is liquidated by specific and actual delivery, it may have been assumed by as many other parties as there are letters in the alphabet. Each of these transactions is apparently new, but is in fact only the transfer of the obligations of the original contract or the substitution of new parties thereto. These several transfers are counted by those who do not understand the

system as cumulative contracts, when as a matter of fact they are successive contracts covering the same obligation.

By way of illustration: Suppose a man had $100 in the bank. He issues a check for this amount, which he delivers to the drawee. This represents the original transaction. Now suppose the man in whose favor the check is drawn, transfers the same to some other payee, and he in turn, to another and so on. Finally the last holder of the check will collect the $100 from the bank and then the original contract represented by the check is specifically performed. In the meantime, however, the check may have passed through a number of hands and may have been the means of liquidating a number of $100 obligations, although there has never at any time been any more than $100 in the bank against which the check was drawn. Each one of these transfers was a perfectly valid and proper transaction and yet if we take the cumulative total we will find that business amounting to $1,000, perhaps, had been transacted on the one $100 check. The argument of the anti-future advocates, if applied to this illustration, would hold that only the original transaction was valid and that the transactions in excess of the $100 in bank were spurious and counterfeit.

The foregoing explanation accounts for some of the apparent excess of future purchases and sales, but there are other important explanatory phases of this seeming discrepancy, which should be considered.

If the contention that the number of bales legitimately bought and sold for future delivery must be limited to the number of bales actually in existence, was sound, then only one man could hedge a given lot of cotton and he could only hedge it once. If this contention was sound, then the first owner could legitimately hedge, but the second, or third, or fourth owner could not: or the owner could legitimately hedge his cotton by selling a contract against it for delivery in a specified month, but if when that month came and he was not ready to deliver and he transferred his contract to mature

in another month, then such second contract, although it covered the identical same bales of cotton would be a gambling contract and a counterfeit. Such is the reasoning of the anti-future advocates mentioned, as applied to the actual and every day transactions in the cotton business. The fact that it is not only legitimate but necessary in instances that the same lot of cotton must be hedged by several different owners, or by the same owner several different times has a large share in explaining the apparent excess of future purchases and sales complained of, and definitely exposes the fallacy of the dogma that the excess of cumulative purchases and sales for future delivery over the number of bales actually grown, is proof of the speculative and injurious character of future contracts.

EXCHANGES MUST BE IMPARTIAL AND CONTRACT FAIR.

The nature of the future contract has now been explained and an exposition of the system by which the same is successively transferred and finally liquidated has been given. It now begins to be apparent how great a part the future contract and the future trading facility plays in the actual spot transactions whereby the crop is moved at the least expense and risk to all concerned. In the next article we will show the practical application of future contract trading to the actual spot business, and illustrate the dependence of the non-speculative dealer, whether he be producer, merchant, buyer, exporter or spinner, thereon.

These discussions, designed to impress upon the farmers and all interested in cotton the great importance of exchanges and of the future trading system to the modern economy of trade, be it clearly understood, presupposes honesty and fairness in the operation of the system and a just and considerate attitude on the part of the exchanges to the interest and rights of all, whether members thereof or not, who are concerned with the commodity which is the subject of trading therein. A future contract that is unfair in its terms,

and rules that give either party to the contract an opportunity to manipulate the value of the same, constitutes an evil which greatly impairs the benefits of the system, and should not be tolerated. An exchange which assumes the attitude that it is a private corporation and that the dominant element of the membership have the right to conduct their business in their own way, for their own profit and regardless of the rights and interest of other members and of outside parties, is an evil-breeding element in the body economic which should be castigated into a proper disposition or else eradicated from a system which it degrades. We shall earnestly endeavor by appeals to the reason of our readers to emphasize the great importance of properly organized and conducted exchanges, and the indispensable function of a properly regulated system of future trading; but we are no less determined to bring into bold review the delinquencies of men and institutions and the drawbacks which militate against the best interests of the cotton trade. It is only by a proper appreciation of the good and an adequate understanding of the evils, that we shall be able to arrive at a conclusion which will enable us to preserve the one and destroy the other. An intimate knowledge of the healthful functions of the body and of the distempers to which it is subject is equally necessary, if we would conserve the one and cure the other, or if we would avoid wrecking the organic constitution by a bungling and brutal attack upon a local disorder.

CHAPTER IV.

The Application of Future Contract Trading to Spot Transactions.

The spectacular and offensive incidents of future contract trading are generally known and widely advertised; but the normal operation thereof, and the indispensable part that such trading plays in the necessary machinery of modern spot business, has not been to any extent exploited; with the result that the real significance of the system is by the general public, and even by the majority of cotton people themselves, either dimly appreciated or utterly misunderstood. The reason for this *ex parte* distribution of information and the explanation of this lop-sided status, is at hand. We pay little heed to the normal, every day operation of either economic or natural laws or systems; and are dependent upon exceptional and untoward developments in order that our attention may be directed thereto. We accept the even dispensation of sunshine and rain, and the customary revolutions of the seasons, as matters of course, and so long as our pleasure and progress suffers no interference, we give no thought to the marvelous adjustment of forces from which these phenomena proceed. But let drought come, or flood, or let the summer be too hot, or the winter too cold, or let the vivid accounts of storm and disaster be published, and immediately our attention is attracted and our disapprobation of the order of things expressed. We know little and think little of the manifold excellencies of the laws of living and growing, but we are prone to magnify the occasional instances of miscarriage; and thus to accept the exceptions, not as proof of the rule, but as the rule itself.

So it is with economic forces, and so with the system we are now discussing. The farmer takes his cotton to town, sells it to

his merchant or to a cotton buyer, buys his goods, puts his balance into his pocket and goes home. To him this transaction constitutes the whole problem of marketing. Of course, he knows in a general way that the buyer of the cotton must have some merchant or spinner with whom he has arranged to place his purchases, or else must be in a position to carry the same until such time as he can dispose of them. He knows, of course, in a general way, that the buyer must make arrangements to get money with which to pay for the cotton bought. He appreciates, if you call his attention to the fact, that the cotton must be shipped on a long journey by rail or over seas, and that pending arrival at market or destination, material changes in value may occur. He knows, also, if you mention the matter to him, that the spinner to whom the cotton goes has created the necessity for it by contracting far ahead for the sale of the product of his mills. He must be apprised, if he thinks of it, that the vast forward and onward movement of the crop which gives him practically at all times a ready and convenient market for his product, is not dependent upon the haphazard and venturesome disposition of buyers, but upon system and business order. He may have been told that the growth of the multitude of interior markets, the multiplication of the number of cotton buyers, and the ability of the latter to pay at all times the highest competitive price, are based upon the great protective principle of "hedging," which can be securel only in the future contract markets. But so long as he can bring his cotton to town, sell it to his merchant or to a buyer, buy his goods, pocket his balance and go home, he takes it all as a matter of course and concerns himself not with the principles of the system to which he is beholden. When, however, by reason of some unlooked for changes in the relation of supply and demand, wide variations in the price of cotton occur; or when some bold speculator, by anticipating such variations, executes a coup and amasses a fortune thereby; or when some unfortunate victim of weakness and folly, because of losses incurred through speculation,

commits the crime of embezzlement or makes an end of his life; the spectacular facts are featured as news items by the press, and thus attract the attention of the public, not as isolated incidents of future trading, but as the flower and fruit and comprehensive end of the system itself. The dramatic accidents of speculation in future contracts and the human casualties associated therewith, are published broadcast to the world; but the thousands and millions of bales of cotton that are each day and each year bought and sold for future delivery in the regular course of non-speculative business; and the multitudinous transactions in contracts, by means of which producers and merchants, and buyers, and spinners, and bankers, are enabled to avoid becoming speculators, and are assisted in the advantageous movement of the crop from field to spindle, are unheralded and to a great extent unknown. Thus becomes obvious the truth of our former saying that we pay little heed to the normal operation of either economic or natural laws, but attend to exceptional adverse developments. We are prone to judge an economic system, as well as a natural one, not by the routine benefits of operation, but by the occasional incidents of miscarriage. While it is no part of our purpose to defend or excuse what is reprehensible in future trading, yet we conceive that it is not only just but necessary for our common good, that the normal and indispensable workings of the system should be explained and emphasized.

HOW THE SPINNER USES THE FUTURE CONTRACT MARKET: THE BENEFITS OF SUCH USE.

In a former article we showed how contracts were bought and sold and how the protective benefits of these contracts might be secured. We will now show just how the buyers and sellers and spinners of actual cotton do avail themselves of this protection, and will point out some of the important results that flow therefrom.

The manufacturer constitutes the ultimate market for raw cotton. The more business there is for the mills, the greater will be the

demand for cotton; and the greater such demand, the higher will be the price paid for the raw material. The spinner enlarges his business and increases the output of his mills and the consumption of the same, by soliciting orders for his product. He, either by representatives or through advertisement, traverses his own country and invades foreign lands, thereby creating a wider market for cotton goods and new uses for the raw material. In order that the spinner may thus extend his business, and sell the output of his mills in advance, he must be in a position to make contracts with the merchants whose attention he secures. He must be able to name a price at which he can supply the future wants of such merchants; as, otherwise, the latter would not know what, or how much, he could afford to buy. But the spinner cannot make this price in advance, unless he knows what it will cost him to get the cotton which he must spin into cloth to fill the merchant's order. If he did not know this cost, he either could not make the contract with the merchant at all, or else he would name a price for the goods high enough to protect him against any supposable advance in the price of the raw material which he must subsequently procure. In the first case the great forward business between spinner and merchant would be rendered impossible; and in the other case, it would be materially curtailed by the high price the spinner must name in order to cover the speculative risk entailed. The great forward business between merchant and spinner, which provides future employment for the mills and creates a demand for raw cotton long before it is produced, is, therefore, dependent upon the ability of the spinner to accurately apprise himself of the future cost of his supplies and to assure himself that he will be able to make his purchases on the ascertained basis. The spinner is able to secure this necessary information and protection in the future contract markets, and in no other way: and if he was deprived of this facility, all his calculations would run awry and the great ultimate market for the farmer's product would be contracted and

consumption curtailed. Let us seek a practical illustration of how the spinner avails himself of this important trade agency.

The spinner, let us say, solicits orders from the cloth merchant—either in domestic centers of consumption or perhaps in far-away China or Japan—to supply the wants of the latter for a long period ahead. The cotton which the spinner proposes to use for the order has probably not been planted. The merchant asks the price at which the spinner will deliver the goods at the time stated. The spinner consults the quotations in the future markets for the several future months and finds that he can buy contracts for the desired amount of cotton at certain figures. To these figures he adds the cost of manufacture, the expense, etc., and his profit, and names the resultant price to the merchant. When the contract between the spinner and the merchant is closed, the former gives his broker an order to buy for his account so many bales of cotton for future delivery. When these contracts are bought, the spinner is protected in his contract with the merchant. It makes no difference to either what the market for cotton may do in the meantime, the merchant gets his cloth at the price stated, and the spinner will manufacture the cloth and realize the profit upon which he had calculated. As the spinner needs the cotton for his contract with the cloth merchant, he generally goes into the spot market and buys. He does this, instead of taking delivery on the future contract, because it may be more convenient for him to buy at or near his home instead of at the place where the future contract must be performed; and for the additional reason that, by going into the spot market, he can make a selection of the exact grades and particular staples desired. When the spinner has bought the spot cotton mentioned, he has no further use for the future contract, as it has completed its mission of insurance. He, therefore, instructs his broker to sell the contract, or, in other words, to get some one to take his place as the purchaser or receiver. The broker sells the contract to some one who wants the cotton at the time specified, or to some other spinner who is in

need of the same protection as the first mentioned, or to some trader who is willing to buy because he believes that the price of cotton will advance.

The importance of the hedging function of future contract trading which the spinner employs, not only directly to the spinner's business, but to the profit of producer and consumer alike, cannot be fully appreciated unless we consider what would be the situation if such trading was prohibited. In such case the spinner would be placed in a position where he could not contract to sell his goods until such time as he had the cotton for the manufacture thereof actually in hand. This would not only curtail his business, and in consequence decrease the consumptive demand, but would put the spinner under the necessity of carrying large and cumbersome stocks. This necessity would make his raw material cost him more and would decrease the price that he or his agent could pay the farmer. Or, if the spinner, being of an enterprising disposition, undertook to make forward contracts with the cloth merchant, in spite of the fact that he could not hedge or protect such contracts by purchases in the future market, the result would be a distinct disadvantage to all concerned. Either the spinner would be obliged to take a speculative risk which eventually would end in his undoing, or else he would have to name a price for his cloth on future delivery which, if it did not discourage the merchant from accepting, would necessarily curtail the demand for raw cotton and increase the price of cotton goods to the ultimate consumer or wearer thereof. From all this it will appear that the effect of future contract trading as it is applied by the spinner to his business, is to broaden and increase the consumption of cotton, to make a wider market and a better price for the producer, and at the same time decrease the cost of the manufactured cloth to the farmer and all other users of cotton goods.

Thus the farmer who comes to town, sells his cotton, buys his goods, pockets his balance and goes home, is dependent for his

market and for his prices to a much greater extent than he appreciates, upon the system of trade which enables the spinners of the world to increase their consumption of cotton and at the same time permits them to place their manufactured product upon the market at a price which does not include the speculative margin which they would have to retain and which the ultimate consumer would have to pay, if the protection of this system was not to be secured.

But this is only one phase of the practical utilization of the future contract in the complex system of modern trade. There is another phase, which has a more direct and intimate relation to the actual markets the producer finds for his cotton and to the price he obtains therefor. The discussion of this branch of the subject will appear in another issue, and will show how the cotton buyer uses the future contract as a protection against the speculative risk otherwise incident to his purchases, and how this protection tends to multiply the number of buyers, to stimulate competition, and finally to give the producer more numerous, more convenient and better markets, and higher prices for his product.

CHAPTER V.

Further Discussion of Application of Future Contract Trading to Spot Transactions.

In the preceding article we undertook to show the dependence of the spinner upon the hedging, or protective, function of future contract trading; and we discussed the important relation of this usage to the spinners' business directly, and indirectly, to the cotton producers' and consumers' markets.

We will now endeavor to explain that relation of future contract trading which more obviously and directly affects the producers' markets, but which none the less vitally, although indirectly, furthers the profitable and economic operation of the manufacturing industry and contributes to the profit of the ultimate consumer or wearer of cotton goods. Reference is here made to the use of the protective agency of the future contract by the buyers of spot cotton, who obviously constitute the direct source of demand, and supply the primary markets for the farmer's product.

When we have thus considered the practical benefit of future trading from the spinner's standpoint, as the same affects him directly, and the producer and consumer collaterally: and when we have considered the practical benefits of such trading as the same affects the buyer's ability to make actual purchases from the farmer and to carry the same, and to supply the spinner in accordance with the latter's needs, we will have some conception of the complex system by which, in modern times, the crop is moved and distributed, some understanding of the integral and essential part that future trading plays in such system, and some appreciation of the disturbance, disorder and loss that would follow the summary elimination of such trading therefrom.

NECESSITY FOR MANY MARKETS AND NUMEROUS SPOT BUYERS.

It is a well-noted fact that the bulk of the cotton crop passes from the farmers' hands during the period of three or four months. This supply ordinarily suffices for the needs of the mills during the entire twelve months. The farmer markets his crop within a brief period; the spinner takes a very much longer period for working this crop into cloth. If, therefore, there were no buyers in the market other than the spinner or the actual manufacturer of cotton, one of two results would follow: either the spinner would be obliged to buy his twelve months' supply during the fall months and carry the same on storage, making requisition on his stock for the current needs of his mill; or else the farmer would be compelled to carry the stock and sell to the spinner only at such time and in such quantities as the latter required.

If the spinner carried the stock, he would find it necessary, in the first place, to make arrangements for large financial accommodations to enable him to pay for the cotton so bought and held; and, in the second place, he would be put to very considerable expense in the items of interest, storage charges, insurance, etc., in order that he might keep the necessary stock on hand. In this event the spinner would be confronted with inevitable curtailment in the volume of his output, and would in addition, if he attempted to sustain such condition, be put upon a choice between two alternatives: either he would have to reduce the price he could pay for cotton to a figure which would reimburse him for his additional expense and risk as above noted, or else he would refuse to buy more than his current needs, thereby forcing upon the farmer the necessity of carrying the stocks, with all the expense and risk incident to such custody. In either case the burden would fall upon the farmer. In a contest between the spinner and the farmer, without the intervention of any third factor, it is perfectly obvious that the spinner, on account of his more compact and powerful organization,

and larger financial resources, would prove the stronger. In such case, therefore, we can conclude with entire certainty that the spinner would adopt the policy of graduating his purchases to his current needs, and force the farmer into the assumption of the burden which the stronger party had declined.

The burden thus falling upon the farmer, let us see what he would do, if there were no buyers in the market other than the spinner. He, like the spinner in the preceding analysis, would find himself confronted by two alternatives, but unlike the spinner, he would find no happy issue out of either. He would either have to store, finance and insure the stock at his own expense and risk, pending the call of the spinner; or else he would have to offer his cotton down and down until the bargain basis was reached at which the spinner would be induced to buy and assume the expense and risk aforesaid. In either case the farmer would be the loser, and his unfortunate position would be aggravated by the fact that he would again, unlike the spinner, have no one upon whom to shift the burden.

If the farmer had large credit, inexpensive storage and insurance facilities, and was able to borrow money at low interest rates, he might be able to carry his crop and distribute it gradually and profitably, but, unfortunately, under present conditions, he is not so equipped. Even a superficial knowledge of the situation would lead us to the conclusion that if there were no buyers but the spinners, the farmer would be under the necessity of offering his cotton down until a price was reached which the spinner was willing to pay; or in other words, the spinner would dictate the price at which the farmer would sell his crop. All of which proves with the unerring certainty of a logical demonstration, that the salvation of the producer depends upon the presence in the market of some buying power independent of the spinner and intermediate between the latter and himself.

Fortunately, there are in the market other buyers than the spinners, or those who actually use cotton as manufacturers. In

the evolution of the cotton trade there have become established, in addition to the larger port markets, hundreds and thousands of smaller markets scattered throughout the interior of the entire Cotton Belt, and each of these markets is supplied with its quota of buyers. These buyers do not themselves manufacture cotton, but stand between the producer and the spinner, buying from the former when he wants to sell, and selling to the latter when he wants to buy. It thus falls out that when the farmer hauls his cotton to town, he will there find buyers ready to make him bids. He is, therefore, relieved from the necessity of carrying his crop, or else of sacrificing it at the spinner's dictation; and if his town happens to be in communication with one of the great exchanges of the country, he knows what cotton is worth throughout the world, and is in a position to demand value therefor.

FUTURE TRADING AS A FACTOR IN THE EXISTENCE OF INTERIOR MARKETS AND COMPETITIVE BUYING.

It cannot be denied that the greater the number of primary markets there are, the more advantageous will be the situation of the farmer; nor can it be questioned that the larger the number of buyers and the more active the competition, the better will be the price paid the farmer for his cotton. Any system, therefore, which tends to increase the number of markets and buyers, is valuable; and if such system makes possible the existence of numerous markets, otherwise impossible; and makes feasible the activities of a multitude of buyers, otherwise unfeasible, then such system becomes invaluable. The farmers of the South have no more vital issue confronting them than the preservation and improvement of their markets and the multiplication of the sources of demand for their cotton.

It is pertinent here to note that the evolution of the small interior market and the growth of the competitive buying force, have been co-incident with the development and utilization of the

protective functions of future contract trading. It is also a fact worthy of attention that the era of high prices for cotton has been contemporaneous with the period of increased activity in the future markets. These co-incidences, although striking, prove nothing unless it can be shown that the relation between future trading and the important facts mentioned is sequent. Here again appeal must be made to the relevant evidence supplied by the spot transactions of the buyers and sellers in the markets described. We have heretofore made the statement that without the protective hedge afforded by the future market, the spinner could not project his activities into the future, and, by contracting his output ahead, enlarge the requirements of his mills, and in consequence increase the consumptive demand for cotton and add to the value thereof; and we endeavored to demonstrate the truth of this statement by showing just how the spinner used the future market for the hedging purpose, and by pointing out the logical effect of such use in practical cases. We now make the statement that the small spot buyer is enabled to compete with the larger; that the multitude of markets and buyers is developed; that the producer is relieved from the pressure of supply; and that the higher level of prices is maintained, through the instrumentality of the hedging function of future trading. In support of this statement we will show how spot purchases and sales are protected and encouraged by the use of the future contract hedge and describe the practical detail of such transactions.

HOW THE SPOT BUYER USES THE FUTURE CONTRACT MARKET: BENEFITS OF SUCH USE.

We will take first the case of a spot buyer who has an opportunity to contract with a spinner to deliver to the latter at a future time a certain number of bales of cotton of specific grades and staple. The buyer, we will say, has not the cotton in hand at the time, and perhaps the cotton with which he would fill such contract has not been made. If he could not protect himself, he either

would not make the contract with the spinner, or else he would name a price which in his opinion would be high enough to protect him against any supposable advance in the market before he could buy. In the latter case the price named would probably discourage the spinner and result in failure to contract, or else the buyer would become a speculator on the market. But observe the difference when the buyer has the advantage of a future contract market. He looks to see at what figure he could buy contracts for future delivery, and to this price he would add only his commission, or profit, and name the resultant figure to the spinner. When the offer was accepted, the said buyer would at once instruct his broker to buy a future contract for a sufficient number of bales to protect his obligation with the spinner. When this was done it would make no difference to the buyer how much the market might advance before he could buy his spot cotton: he would be protected by his future hedge. Thus a forward demand would be created for the actual cotton. When the farmer finally brought his cotton to town he would find the buyer waiting for him and prepared to pay the highest market price justified by the law of supply and demand. As soon as the buyer purchased the spot cotton, the need of the hedge would terminate, and he would, therefore, instruct his broker to sell his contracts, or in other words, to get some one else to take his place as purchaser therein. The broker would make this sale, or transfer, to some other buyer or spinner who needed the protection which the first buyer had enjoyed, or to some trader who believed that the price of cotton would advance.

Or consider the situation during the fall months when the movement from the fields is heavy and cotton is coming to market over every road. The buyer, we will assume, has filled all orders in hand and in so far as his contracts are concerned, has no need for cotton. If in such case he did not have the facility of hedging in the future market, he would not buy at all, or else would offer the farmer a price low enough to protect him, the buyer, from any supposable decline that might occur between the time he made the

purchase and the time he could place the cotton with the mills. The situation of the farmer would, therefore, be that either he would find no market at all at such times, or else he would have to sell at a price low enough to induce the buyer to take a speculative venture. But observe the difference wrought by the fact of a future market, in which the buyer could hedge any purchases he might make. The buyer, in the situation mentioned, would look at the prices at which future contracts were being bought and sold: from this figure he would deduct his commission, or profit, and the resultant price would be what he could afford to bid the farmer. If the offere was accepted the buyer would immediately instruct his broker to sell contracts for a sufficient number of bales to cover his purchase; and thereafter it would make no difference how much the market declined he would still be sure of his profit or commission. When in the course of business the spinner came into the market again, the buyer in question would sell his spot holdings at the current spot price, and then he would buy in his contract, or in other words, find some other spot holder or spinner who desired the protection he wished to relinquish, or some trader who thought prices would decline, to take his position and assume his obligation in the future contract.

Multiply the two foregoing typical transactions by the many of the same kind that these two buyers would probably effect: and multiply these two buyers by the many thousands who operate upon this protected basis and make their commission or profit without any risk of loss: and then the reason why there are manifold markets and a multitude of buyers, becomes strikingly obvious. The corollary of this proposition is equally plain. Take away the protection upon which the buyers and markets depend and the number of both and the activity of competition will be seriously if not hopelessly curtailed and impaired.

The foregoing transactions represent typical instances of the application of future contract trading to the spot transactions by which the crop is marketed and moved. We shall have a few more

observations to make concerning the general phases of the protective system of hedging and its fundamental importance, and then we will consider the no less momentous question of the misuse and abuses of future contract trading which have earned the condemnation of all right-thinking and right-acting people.

CHAPTER VI.

Protective Function of the Future Contract.

Ownership involves risk. All personal possessions are subject to destruction or damage. Fire, water, accidents and elemental disturbances incessantly threaten property. A man's possessions, whether they be great or small—whether they constitute the valuable accumulations of the rich or the meager holdings of the poor—may in a night be reduced to ashes and dissipated in smoke, or in an hour flattened to the earth by wind and storm. The effort of property-holders in all times has been to minimize this risk and protect themselves against the consequences of this inherent peril. Precaution is an important element in this undertaking, but more is needed. Precaution may lessen the chance of mishap, but it does not obviate the fact of loss. In order that the value of a commodity or thing may be maintained at the maximum, the owner must be *protected* against these risks of ownership. The essential value of this protection lies not so much in the expectation or assurance that the owner will take care of his property, as in the fact that if it is damaged or destroyed he will be reimbursed. The extent to which this protection may be secured affects the value of all property subject thereto. The more complete this protection, the greater will be the value of the property covered thereby. What is here asserted concerning the *thing* protected, is also true of the contracts that relate thereto. Hence, the value of destructible possession, whether considered from the standpoint of utility to the owner or as an item for sale, or hypothecation as collateral to a loan, is enhanced by this protection. This indemnifying principle is called insurance; and the agencies which assume the risks that would otherwise be borne by the owner, and which, in effect, make indestructible the possession insured, thereby causing ownership to

be more profitable and adding value to the thing owned, are called insurers, or in business parlance, underwriting associations or insurance companies.

INSURANCE.

It is impossible to estimate the value of the insurance principle. It is inextricably interwoven with the fabric of all modern industrial, commercial and domestic life. Its application is unlimited and its scope universal. Rich and poor are beholden to this protective agency; and great and small share alike in its benefits. Insurance protects the prosperous and rehabilitates the unfortunate. It is equally essential to the business of the small storekeeper and to the operations of the greatest merchant. It is at once the conservator of values and the basis of credit. It is more: it is the great economic equalizer—the foundation upon which the commercial democracy is built. If the insurance principle were eliminated, not only would acute shrinkage occur in the value of all presently insurable commodities, and not only would the business of the country be disorganized, but the poor man and the small merchant would be driven to the wall, because only the rich and strong could afford, themselves, to assume the risk that goes with ownership of property and follows traffic therein. Although the undertaking of the underwriters, or insurers, is essentially speculative in its nature, and although there are instances in which some insurance policies do not in fact supply the protection they purport to give, still it would be a rash man, and a foolish one, who would, for these reasons, declare against the principle of insurance, prohibit all underwriters from assuming risks, and deprive mankind of one of its most enlightened, comprehensive and beneficent economic forces.

INSURANCE AGAINST PHYSICAL LOSS OR DAMAGE.

In order that we may give the foregoing generalizations some concrete application, let us consider how the insurance principle affects cotton and the traffic therein.

Almost from the time the cotton is made to the time it is spun into cloth it is continuously covered by policies of fire or marine insurance. Usually this protection is applied as soon as the wagon deposits its load of seed cotton at the gin: always the cotton is covered while in the hands of the buyer or merchant or spinner, whether stored in warehouse or in course of transportation by rail or boat or steamship. The importance of this protection both to buyer and seller can hardly be estimated. As soon as the buyer purchases the cotton he takes out a policy of insurance thereon. Indeed if he did not he probably could not buy cotton at all, because the banks would not let him have the money with which to finance his purchases. The banks would not be willing to advance money on collaterals which might in a few hours be totally destroyed. Similar conditions would surround the cotton as it passed from owner to owner on its way to the spindles. If the buyer could not insure his cotton against destruction or damage by fire or water, he would be obliged to carry the risk himself. In such case he would estimate what this risk would probably cost him and deduct this amount from the price he offered for the cotton: thus the burden of this risk would fall upon the producer, and he would pay for it in the reduced price that he realized for his cotton. The risk to the individual buyer of small or average means is much greater than it would be to the great insurance companies, with their innumerable sources of recoupment, hence the amount reserved by such buyers would be largely in excess of the premiums charged by the insurance companies.

But this is assuming that the buyers would be able themselves to carry the risk. As a matter of fact, the great majority of buyers would not be so able. The majority of buyers are able to do business because they can insure, and if they could not insure they would be forced out of business. The banks will lend money on cotton without any additional collateral, provided that the cotton is insured against loss, but without such insurance they will require

that the borrower be able to respond out of his collateral means to cover any loss that might occur. This would eliminate all buyers from the market except the few whose credit was such that they could borrow without regard to the value of the cotton collateral in hand. Inasmuch as the crop is practically moved on borrowed capital, the elimination of insurance would drive out of business the buyers of small or limited means and would turn the business to the hands of a few great concerns or corporations which were strong enough to carry the risk. Thus the producer would not only be deprived of the high-price basis established by a multitude of buyers in active competition, but he would be compelled to accept the low price fixed by an assured non-competitive combination, and would in addition be required by such combination to underwrite the fire and marine risks as heretofore explained. There is no more important factor in all the economy of trade than this insurance principle. It is directly instrumental in broadening the market for cotton, increasing the value thereof and establishing the maximum price justified by the relation of supply and demand.

INSURANCE AGAINST FLUCTUATIONS IN VALUE.

It may seem that we have entered with unnecessary particularity into the analysis and discussion of the function and benefits of protective insurance. It is all so obvious and customary, some may say, that reiteration is unnecessary and tedious. At the risk of this criticism we are determined to emphasize the importance of the protective function of ordinary insurance, because the protective function of future contract trading is identical in principle with that of ordinary insurance, differing therefrom only in extent or degree: and we have taken pains to set out the reasons why ordinary insurance is beneficial and essential, in order that the claim of special protection supplied by future contract trading may be tested by the logical precepts in the first case laid down.

Fire and marine insurance protects the owner of cotton from

the risk of physical destruction of his property, or damage thereto. But the physical hazard by no means comprehends all the risk involved. The value of cotton and the status of contracts relating to the ownership thereof, are affected by fluctuations in price. Frequent and perhaps material fluctuations in the price of cotton are natural and logical. The comprehensive character of the demand for cotton makes such variations inevitable. Cotton is a world-desired and a world-used commodity and the world itself is the field upon which is waged the contest between the forces of supply and demand. Drought in Texas, too much rain in the Mississippi Valley, frost in Georgia, financial stringency in New York, labor troubles in Manchester, war in Russia, dynastic tremblings in China, crop failure in Egypt or India, and innumerable other contingencies all affect the value of cotton and produce quickly responsive changes in the price thereof. The risk of fluctuation in price is just as obvious and real as the risk of loss or damage by fire or water, and is of very much larger significance. Comparatively, only a few bales are reached by physical mishap or disaster, but price fluctuations affect every bale and pound of cotton in existence. If it be important for the stability of trade conditions and for the maintenance of competitive demand, that owners and holders of cotton shall be protected from loss by fire and water; how much more important is it, for these considerations, that such owners and holders should be protected from loss by reason of fluctuations in price?

Fire or marine policies may be purchased from insurance companies whose business it is, for a consideration, to assume such risks. There are no insurance companies, as such, which underwrite the risks incident to price variations; but this invaluable protection can be secured and is secured to an unlimited extent and on easy terms, during every hour of every business day and by any one who desires or needs the same. This insurance is available in the future contract markets and nowhere else, and this

protection is available for commodities for which there is a future contract market, and for none other. In former articles we have shown just how the succesive owners of cotton are affected by these price fluctuations; and have pointed out the exact method by which they may obtain the required insurance, through the purchase and sale and transfer of valid and binding contracts under the auspices of legitimate Exchanges. Thus becomes apparent the momentous consequence of the protective function of the future contract, and with this appreciation comes conviction of the solemn duty of the Exchanges to administer this function in equity and honesty. The better we understand the far-reaching benefits of this protective principle the more appalling appears the consequences of undiscriminating assaults upon the system through which these benefits are secured; and the better we appreciate the indispensable agency of this system in the desired result, the more determined should we be to rid it of its weaknesses and contribute to its strength.

CHAPTER VII.

In Reference to United States Government Report on Cotton Exchanges.

In the preceding articles we have discussed the nature and functions of a legitimate Exchange, as differentiated from the bucket shop; the nature of the future contract and methods of trading therein; the application of future trading to spot transactions; and finally the protective or insurance value of the future contract system. By statement of fact, by analysis, and by deduction, we have endeavored to show that the properly organized and regulated Exchange is an essentially beneficial institution; that the future contract sanctioned and utilized in such Exchange is an honest, valid and binding trade obligation; and that the trading on such Exchange, in such contract, supplies the means whereby speculation in spot transactions may be avoided through the medium of the hedging facility thereof, to the direct and indirect, immediate and ultimate advantage of buyer and spinner, producer and consumer, and of the cotton trade at large.

We have by no means exhausted the catalogue of benefits conferred by a fairly regulated system of future trading; we have merely stated the fundamental principles and cited the typical instances of the operation thereof. But we will not prolong the discussion of this favorable phase of the system beyond the limits of this article. We have, we hope, established the fundamental merit of the system, but before proceeding to the analysis of the untoward features of the same and to the discussion of the remedies therefor, we think it well to cite some expert and disinterested authority in support of our conclusions.

Under a resolution adopted by the House of Representatives in February 1907, the Department of Commerce and Labor, through

the Bureau of Corporations, was directed to make an investigation of the Cotton Exchanges dealing in future contracts.

The Commissioner of said Bureau, Hon. Herbert Knox Smith, conducted during a period of more than two years a searching investigation, and issued a report setting forth the facts developed, and his conclusions therefrom. This report is one of the most comprehensive and luminous economic treatises of modern times, and will well repay the study of all who desire full and accurate knowledge of this important subject. The report discusses not only the evil developments of future trading, and the remedies therefor, but also takes notice of the benfits thereof.

NATURE OF COTTON EXCHANGES.

Under this head, Commissioner Smith, in Part 1, of the report, pages 56-57, says:

"It should be clearly understood that whilst most of these "cotton exchanges are corporations they are not engaged as such in "the cotton business in any way. Instead, they are mere associations "of individuals who in their financial operations are free to act "as they like, subject to the general regulations of the exchange. "Exchanges as such do not buy or sell cotton, and, except that "occasionally some exchange derive a small income from fees for "the inspection or grading of cotton, they have no direct financial "interest in the product itself. Their income is derived from mem- "bership dues, rents of buildings, investments, or similar sources. "This characteristic of cotton exchanges should be clearly "appreciated. The impression which appears to exist in some "quarters that exchanges in their corporate capacity act as a unit "in the cotton market is altogether erroneous. Market operations "in cotton are wholly matters of individual concern. Moreover, "the individual members of exchanges, instead of having a com- "mon interest and acting as a unit, ordinarily have market interests "of the most diverse and conflicting character. It is true that from "time to time certain members of exchanges act in unison by

"means of so-called cliques or pools, but it is entirely safe to say "that it has never happened that such cliques have included the "entire membership of an exchange. The idea that all the members "of an exchange are banded together as a unit to prey upon the "outside trader is not well founded. Outsiders have undoubtedly "suffered from the co-operative efforts of certain members of "exchanges to manipulate prices, but such concerted manipulation "is not conducted by an exchange, as such or by all the members "acting together. Unjust rules, it is true, may have been adopted "from time to time by exchanges in their official capacity, but this "is a matter distinct from actual financial dealings in cotton, and "one with which this report deals at some length."

BINDING NATURE OF FUTURE CONTRACTS.

In support of our conclusions under the above head, we quote Mr. Smith, Part 1, pages 43-44:

"In the first place, a future contract is, as its name implies, "a definite agreement on the part of one party to deliver to another "party, who in turn agrees to receive, a certain quantity of mer-"chandise within a fixed period of time at a fixed price. While "such contracts when first made are usually confirmed merely by "word, or even by a sign, such as the uplifting of a finger or a "nod of the head, they are later recorded, either in full or in the "form of a memorandum of the same force and effect and are "absolutely binding upon the parties entering into them. The seller "of such a contract is absolutely liable for the delivery, and if "called upon for such delivery by the buyer he can in no way avoid "compliance with terms of his contract except under unusual "conditions especially provided for. Failure to make such delivery "will subject him, in all probability, to suspension, at least tem-"porarily, from the exchange with which he is connected, and render "him liable to legal action on the part of the purchaser. In actual "practice it is undoubtedly true that a large number, and probably "a considerable majority, of buyers of future contracts on the

"leading exchanges do not desire the delivery of actual cotton, and "that a majority of sellers, on the other hand, do not contemplate "making such physical delivery. Such a buyer of a contract instead "of receiving the actual cotton sells out his contract to another "party, or perhaps to the very man from whom he originally bought "it. In other words, instead of taking the cotton he merely gains "or loses the difference between the price at which he bought his "contract and the price at which he sells it out. The second buyer, "in turn, may have bought the contract with the same speculative "intent, and, instead of receiving actual cotton, may likewise sell "out the contract at any time prior to the date of maturity. "Eventually, however, since the contract has a fixed date of "maturity, the ultimate purchaser must, at the stated time of "delivery, receive the actual cotton—and this whether he desires "to or not. When the time for making delivery has expired, he "cannot sell out his contract. This fact and the fact that any "buyer, from the first to the last, can, if he chooses, hold his "contract and compel the seller to deliver the actual cotton when "the date of maturity arrives give trading in futures a character "entirely different, in principle at least, from that of a mere wager "or bet."

EXTENT OF HEDGING OPERATIONS.

In a former article we explained the apparent excess of future trades over the total supply of spot cotton. Commissioner Smith sustains our contention, in the following extract from his report, Part IV, page 268:

"The same cotton may be hedged over and over again by "different parties, thus counting several times in the total of "hedging transactions. In the first place, a country merchant who "buys cotton from growers and planters in small lots and "accumulates the cotton faster than he can sell it, frequently sells "future contracts as a hedge. The buyer of cotton from such a "country merchant in turn also sells a hedge, or, if he has previously

"sold cotton ahead to spinners, usually he has already bought a "hedge. The spinner likewise may employ a hedge. Still again "the dealer in dry goods, who buys from the spinner, may sell "future contracts as a hedge against a stock of cotton goods which "he may be carrying at a time when he anticipates a decline in its "value. The bulk of hedging transactions in this country, however, "comes from cotton merchants. Most cotton merchants regularly "hedge by either buying or selling future contracts, as the case "may be, and aim never to be long or short of actual cotton to any "extent. Frequently merchants endeavor to balance their accounts "in this respect at the close of each day.

"The same cotton may be hedged repeatedly by a single owner. "Thus, a merchant buying cotton in October might sell a January "contract as a hedge against it; if by January he had not sold the "actual cotton, he could transfer his hedge to a more distant month. "This might be done over and over again until his cotton was "eventually disposed of."

FUTURE SYSTEM AS A MEANS OF INSURANCE AGAINST RISKS OF TRANSACTIONS IN ACTUAL COTTON—THE HEDGING FUNCTION.

On this important division of the subject, Mr. Smith has given an exhaustive disquisition. We quote briefly from Part I, pages 48-49 and 53-54:

"In using the future system to faciliate actual transactions "in spot cotton it is obvious, in the first place, that it may thus "be used by either the grower of cotton or by any other seller to "dispose of his cotton at a distant date by simply selling a contract "maturing at that date, and, when the contract matures, completing "the transaction by a physical delivery of his cotton thereon. Thus, "if, say, in November, January futures—that is, contracts for the "delivery of cotton in January—are comparatively high, a grower "or a holder of cotton may, through some broker on a cotton "exchange, sell such January contracts, and when the month arrives

"deliver or, to use the trade expression, 'tender' the actual cotton "against them.

"In the same way a manufacturer of cotton goods, instead of "buying his entire supply at the beginning of the season, might "in theory distribute his purchases throughout the year by purchas-"ing contracts for different months through a member of a cotton "exchange and as the contracts mature receive actual cotton in "fulfillment of them. Some of the reasons why in practice this "system is not extensively employed by spinners in just this way "will be extensively discussed in a later Part of this report.

"The above description illustrates the simplest use of the "future system. The system is employed in a quite different "manner, however, by buyers and sellers of actual cotton as a sort "of insurance against violent fluctuations in price during the period "between the original purchase or sale and the final delivery of the "product. This employment of the future system, which is "technically known as 'hedging' is an exceedingly important "feature of modern trading in cotton, and, unquestionably, an "extremely valuable one."

"It is apparent from even the brief illustrations given that "a properly conducted future system, through this opportunity for "hedging, affords a great protection to the most legitimate sort of "business and one of almost incalculable value. It should be noted, "however, that hedging does not absolutely guarantee a merchant "from loss, since advances or declines in the price of his future "contracts may not exactly correspond with advances or declines "in the price of spot cotton. The illustrations above given assume "that absolutely correct methods of conducting the future business "have been established. It cannot be too forcibly emphasized, there-"fore, that in practice it has happened at various times that hedges "have afforded a far less perfect measure of protection than above "indicated. This situation really constitutes one of the most "important matters discussed in this report, and cannot be entered "into extensively in this preliminary chapter. The hedging process

"has been explained mainly to show that the future system is "something more than a device for mere speculation, and that it "presents benefits of great value to those conducting business in "actual cotton. In fact, for these, as individuals, the future system, "if properly used, may be said to largely eliminate speculation. "Obviously, for a merchant, without hedging, to buy 10,000, 20,000 "or 50,000 bales of a valuable commodity like cotton, which is "subject to great fluctuation in price, would be a highly speculative "transaction, whereas; under a perfect working of the hedging "system, the element of speculation can be largely avoided. This "opportunity for hedging is, indeed, regarded by practically all "cotton merchants as almost an absolute necessity under modern "methods of conducting business.

"An idea of the value of the hedging function may be obtained "when it is stated that in Great Britain banks very generally refuse "to loan money on cotton which is not hedged. Moreover, it is "almost universally conceded that, since the introduction of hedg-"ing, failures in the cotton trade, which had previously been "frequent, have been materially reduced as a direct result of the "greater stability with which transactions in spot cotton can be "conducted."

NUMBER OF BUYERS AND COMPETITION INCREASED BY FUTURE TRADING.

We have endeavored to emphasize the fact that the protective function of future trading made possible the multitude of small markets and operations of buyers of moderate means, and thereby increased the price paid the producer for his cotton. In this connection Mr. Smith, Part IV, pages 279-280, says:

"Those who argue that the future system tends to advance the "price of cotton for the grower attach much weight to the fact that "the system, on account of the protection afforded by hedging, makes "it possible for men of limited means to become cotton merchants, "and thus to increase competition for the purchase of the product.

"It is unquestionably true that the future system, in the main, "because of the hedging function—imperfectly as it has operated "at times—has made it possible for a great many men of limited "resources to enter the cotton business. Where years ago the busi- "ness of the cotton merchant was attended by tremendous risks, "making it almost essential that he should possess ample capital, at "the present time a large number of cotton buyers of moderate "resources are scattered throughout the cotton belt. It is a common "occurrence to find several of these buyers at a small country town "bidding for cotton as it is brought in from farm or plantation in "wagonloads of a few bales each. While competition in the cotton "business probably would have increased without the future system, "there can be no question that the opportunity for reducing "speculative risks afforded by the hedging function, when properly "safeguarded, has greatly stimulated such competition."

Having now outlined the essential merits of the future contract system and having shown its indispensable relation to the modern trade methods by which the cotton crop is marketed, moved and spun into cloth, we will in the next succeeding articles discuss the misuse of the system and the misbehavior of men and institutions with relation thereto.

CHAPTER VIII.

Future Contract Trading—Injurious Developments Discussed.

In the preceding articles on Future Contract Trading we have endeavored to explain the system itself, to show the practical relation thereof to modern trade methods, and to demonstrate that future trading is not only an important economic agency, but a direct and powerful factor in the advancement of the material interests of both the producer of cotton and the consumer of cotton goods. In short, we have sought to demonstrate the economic value of future contract trading.

In discussing this important issue we are moved by an earnest desire to throw light upon both sides of a much misunderstood problem. We want our readers, and particularly those who are most vitally interested in a wise settlement of the question—namely the cotton farmers,—to secure a clear view of the proposition in its entirety. A prejudiced view of the evils, only, of the system, or an interested view of the good, only, will not suffice for our purpose. We must be apprised of both the good and the evil if we are to adopt a course of action that will be beneficial to our own material interests and just to all the interests concerned.

In the furtherance of this purpose it has seemed best to discuss first the benefits of future trading. Not because the injurious phases are unimportant, and not because we wish to relegate these phases to secondary consideration, but because it is wise to have the essential necessity of the system thoroughly appreciated before indignation is aroused by a recital of the flagrant abuses that have been practiced in its name. This was the mistake made in the early stages of the agitation against future contract trading. Men were incensed by certain abuses and rushed blindly toward the annihilation of a system which they did not understand,

and the good of which had not been brought to their notice. The fact that we have stated the case in favor of future trading as strongly as possible, while proving our conviction of the necessity for it, is by no means to be taken to indicate that we are partisans of the system under any and all circumstances, nor that we think the system, as it has been operated, should be continued. On the contrary, we recognize and utterly condemn the evil developments of the system and the wrongs that have been inflicted through the inequitable operation thereof; and we are as firmly committed to the destruction of these evils and wrongs as we are to the preservation of the beneficial features. Indeed the more strongly we believe in the good that inheres in a properly operated system of future trading, the more implacable is our enmity against those agencies which debauch such system. We have exploited the good in order that it may be utilized and preserved; we will now point out the bad in order that it may be excoriated and destroyed.

BUCKET SHOPPING.

The conspicuous evils that have been attributed to future trading are three in number, to-wit: *Bucket Shopping, Excessive Speculation* and *Manipulation of Prices by Means of Unfair Rules and Practices in the Exchanges.* In a former article it has been shown that Bucket Shopping was simply and solely a gambling device; that its only relation to the system of future trading was that the bucket-shop keepers bet with their victims on the fluctuations that occurred in the value of actual contracts; and that the legitimate exchange and the system of future contract trading was no more responsible for this pernicious practice than was the ocean liner responsible for the bets that were made by its passengers on its speed and daily progress. Furthermore, the Bucket Shop is a specific institution and can be eradicated root and branch by direct legislation without any injury to the system of future contract trading, but with great benefit thereto. Laws have already been passed in all of the Southern States and in practically all the States

of the Union prohibiting Bucket Shopping, and if the practice prevails anywhere it is because the existing laws are not enforced. Excessive speculation and manipulation by the means stated are, therefore, the evils properly to be considered in connection with the system of future contract trading.

EXCESSIVE SPECULATION.

Speculation is in itself not an evil; on the contrary, it is the vivifying principle of trade. If it were possible to eliminate speculation from all business affairs and to limit the purchase and sale of all commodities and things to those who had actual use for such commodities and things and those who had ceased to have use for the same, the value of every material asset would undergo a drastic shrinkage, business would revert to the ox-cart period, opportunity would be smothered, development halted, and the activities of mankind limited to a struggle for actual necessities.

A man has a right to buy, or to contract to buy, a thing, whether he needs it for use or not, if he thinks it is cheap and that later he can dispose of it at a profit. A man has a right to sell, or to contract to sell, a thing, whether he has it in possession or not, if he thinks that the price is high and that he can sell at a profit. This is speculation in its simplest form. The principle runs through all business transactions and cannot be avoided, even if avoidance was advisable. When the farmer invests his money and his labor in his crop, he speculates on the seasons and on the variations of supply and demand. The merchant and the banker, for the consideration of profit, or of interest, speculate upon the capacity of debtors or borrowers, to pay. Insurance companies for the sake of premiums to be earned speculate upon the risks of fire or water or the duration of human life. Everybody speculates. Speculation is an inherent condition of the business and of the social relation. It cannot be eradicated, no matter how hard we may try, and it should not be eradicated even if we had the power to do so. The principle of speculation is, therefore, not only ethical,

but necessary; and not only necessary, but it is the vital dynamic force in trade and an ineradicable impulse of the human-race. It follows that the evil lies not in the principle of speculation, but in the manner in which the principle is employed; not in the use of the principle, but in the abuse of it.

SPECULATION MUST BE REGULATED.

We have heretofore shown how speculation properly regulated is the basis of that insurance upon which the cotton business depends. The men who believe that prices will be higher in the future and buy for future delivery, and the men who believe that prices will be lower in the future and sell for future delivery, are the people who assume the risk, thus enabling the great mass of producers, merchants, bankers, spinners and consumers, to conduct their business on non-speculative lines to the material advantage of all concerned. A properly regulated system of future trading, therefore, supplies the means whereby speculation is limited to the few who are able and willing to take the risk and protection afforded to the unlimited number who are unwilling and unable to assume the risk. A properly regulated system of future trading thus decreases the volume and extent of speculation instead of increasing it. Regulation, therefore, becomes the issue.

EXCESSIVE SPECULATION AN INCIDENT.

Future trading, *per se*. no matter how fair and honest the system may be, is susceptible to abuse in the matter of speculation. The ease and facility with which cotton may be bought for an advance, or sold for a decline, by the transfer of representative contracts; the efforts made and the inducements offered by brokers whose commissions or profit depend upon the volume of speculative business transacted; and the natural tendency of mankind to take a chance of making quick and easy money: all tend toward inducing people to speculate, who have no business in the market, and to-

wards making those who have a legitimate use for the contract, overtrade and take long speculative chances. There is no doubt but that this facility is a danger lurking in any system of future trading, and there is no doubt but that at the time the agitation against future trading began, this excessive speculation was a most reprehensible fact and a flagrant evil.

But since that time nearly all of the Southern States have put anti-future-speculation laws on their statute books. These laws, while unnecessarily drastic, and while they enjoin a great deal more than they accomplish, still have had the effect of practically limiting future trading to those actually engaged in the cotton business and who have an actual need for the future contract; and have effectually prohibited that indscriminate mania for speculation, which before, had invaded all sections of the country, all lines of business and even the homes of the people. The evil of excessive speculation has been, therefore, at the present time minimized, and it can be controlled by the enforcement of proper regulations.

THE CRUX OF THE EVIL.

We have now reached the crux of our discussion. We have shown that the principle of future trading is necessary and beneficial; we have affirmed that the system as it has been operated. has been attended by harmful consequences; we have shown that one of the attributed evils, that of bucket-shopping, has no relation to a properly operated future trading system, and besides has already been largely eliminated and can be entirely destroyed; we have shown that another most conspicuous hurtful development of future trading, excessive speculation, was not a constitutional and inevitable consequence, but an abuse which could be, and which had been in recent years, kept within reasonable limits of restraint. There remains yet to be considered the third evil specified, or the evil of manipulation through unjust, unfair and corrupt methods of operating future contract trading.

In the next and the succeeding articles this abuse will be given attention. We shall find in the wrongful practices specified the fountain head of the trouble and the capital cause of the reproach that has fallen upon the future trade. We shall find that the fault lies not in the principle, nor in the system of trading *per se,* but in unfair and dishonest methods of administering the principle and manipulating the system. After these several abuses have been pointed out and the reason for the existence and the harmful effect thereof discussed, we shall endeavor to recommend the remedies by means of which the system may be shorn of the vices which have been engrafted upon it, and strengthened and perfected for the proper performance of its important economic purpose.

ISSUE ILLUSTRATED.

Because we are approaching the climax of our discussion, it is important that we have the essential issues clearly in mind, and in order that we may have no excuse for confusion in this regard, we shall, even at the expense of repetition, attempt to summarize our analysis by means of an illustration.

The system of navigation plays a most important part in the progress and welfare of the human race. But there are both difficulties and dangers attendant upon the practical effort to navigate. These harmful contingencies may arise from two different causes—they may proceed from the very nature of the undertaking; or from some extraneous overt interference. Of the first class, the happening of storms may be taken as typical; of the second class, piracy is an example. In order to obviate or resist these adverse contingencies, it is not necessary, nor wise, to pass laws prohibiting navigation. The remedy for the first class of mishap is to provide safety appliances and to enforce safe guarding methods; the remedy for the second class of misfortune is to sweep the pirates from the sea.

Applying this illustration to the subject in hand:

TRANSGRESSION, NOT TRADING, SHOULD BE PROHIBITED.

Future contract trading is a system necessary and indispensable to modern business. But there are certain difficulties and dangers attendant upon the practical effort to operate the system. These harmful contingencies may arise either from the nature of the case or from the overt machinations of selfish and designing men. Of the first class the development of indiscriminate and excessive speculation may be taken as typical; of the sceond class, the cotton exchange which has no excuse for existence except as a speculative convenience, and which is operated under unjust and unjustifiable rules for the profit of a coterie of its members at the expense of the outsider, the public, and the producer and consumer of cotton, is an example. To obviate and resist these adverse contingencies, it is neither wise nor necessary to pass laws prohibiting all future contract trading. The remedy for the first contingency is to restrict and regulate the citizen in his conduct—which has already been done: the remedy for the assaults of overt dishonesty, is to proceed against the transgressor. Subsequent discussion will be devoted to this latter phase.

CHAPTER IX.

Future Contract Trading—Further Discussion of Injurious Developments.

A trade agency of such economic value and practical benefit as we have found the future contract to be, would necessarily, if employed under adequate restrictions and proper methods of operation, command universal appreciation and endorsement. We find, however, that the future contract, and trading therein, has been assailed with vindictive bitterness and the whole system is even now the subject of proposed prohibitory legislation pending in Congress. It is not to be supposed that this antagonism proceeds from wanton destructiveness. It, therefore, follows as a logical necessity that the system has not in all instances been employed under proper restrictions and methods. A brief analysis of the anti-future agitation will strengthen this conclusion.

CAUSES OF ANTI-FUTURE AGITATION ANALYZED.

The acute attention of the public was drawn to future trading and a hostile disposition aroused, several years ago by an epidemic of speculation in cotton which seized all classes of our people. Excited by press accounts of great fortunes made in a few days or weeks; stimulated by the tales of easy money gained in the cotton market; and faciliated by the establishment of so-called cotton exchanges in all of the large towns and many of the small ones throughout the South, an injurious condition of affairs was brought about. Farmers, doctors, lawyers, bankers, merchants, clerks and even women and children caught the infection and became speculators in cotton. In addition to the generally demoralizing effect of such conditions, particular instances of indiscretion, misfortune, dishonesty and tragic consequences, still further aggravated the storm of protest. Such conditions were not tolerable,

and the people moved by swift anger struck at the trade system which made such developments possible, and within a brief period almost all the Southern States had placed upon their statute books the drastic anti-future laws aforementioned.

It is probable that this frenzy of speculation would have worn itself out within a limited time, as experience has shown to be the case in similar instances of hectic disorder, but it is an undeniable fact and a fortunate fact that the laws mentioned summarily hastened the desired consummation. But, although, these laws served a good purpose, they, like all laws framed in anger and truculence went too far, proposed too much and did not fit the real necessities of the case. They undertook to destroy the abuses of future trading by denying the citizen the right to trade in future contracts at all. They proposed to deny all men the right to use a necessary trade facility because some men had misused the same. Fortunately, those states in which the future markets were located did not pass these drastic acts, and as no prohibitory federal statute was enacted, the future markets were not destroyed. Thus it was still possible to find a market in which future contracts could be bought and sold; and the citizens of those states which had enacted such laws, whose business and livelihood required the protection afforded by the future contract, found ways to purchase their hedges in spite of the prohibition.

If the future contract exchanges had been closed and the future contract markets destroyed; or even if the strict mandate of the state anti-future laws had been rigidly enforced and the cotton buyers and sellers of such states, had been in fact prohibited from using the future contract facility, there can be no doubt but that the cotton business of those states and of the South would have been demoralized and a united protest would have demanded the repeal of the prohibitory statutes.

OPPOSITION STILL IN EVIDENCE.

But, although the original cause of complaint has been to a great extent removed; and although future contract markets are still in existence and future contracts are available to those who require them in the transaction of their business; still the voice of protest has not been hushed nor the hand of opposition stayed. In the agitation of the future trading question during the past few years and from the investigation of the subject, which has been instituted, the people have learned that excessive speculation and the demoralizing effect thereof on the individual, does not comprise all the injury that has been inflicted or may be inflicted by a wrongful use of a system of future contract trading. They have learned that where the machinery of the system is in powerful, unscrupulous and irresponsible hands, it may be used for the selfish profit of the individuals controlling the same and to the detriment of other individuals and to the injury of the trade. The cotton trade has learned that the system upon which it is dependent, may by unfair regulations and unjust conditions be impaired in its beneficial function and prostituted to the greed of the framers of these regulations and the authors of these conditions. It has been ascertained by interested students of the problem and demonstrated by disinterested investigation and testimony, that one future market in this country has been for years and is, in the face of exposure and condemnation, still persisting in operating under uncommercial, partial and inequitable rules and methods; and has been and is still maintaining and proclaming the arrogant assumption that the object and purpose of its organization and operation is the profit of its members, without consideration for the rights of producers, spinners, consumers or any outside interest whatsoever. The cotton trade has learned that the code of rules employed by this institution has inflicted injury upon legitimate interests, has brought reproach upon exchanges and even threatens the integrity of the great principle of future trading itself.

INDIGNATION SHOULD NOT CLOUD JUDGMENT.

But we must not permit our indignation to cloud our judgment, nor must we allow our resentment to lead us into any extreme or destructive measures which will accomplish more than we intend or more than the cotton trade can stand. It is not only right, but it is necessary that future contract exchanges shall be required to deal fairly with the trading public, but it is neither right nor necessary, in order to attempt this result, to destroy all such exchanges or to prohibit future contract trading, either by specific legislative denial or by the imposition of conditions which will make such trading impracticable or impossible. We must preserve the future contract exchange and perfect the future contract trading system, but the exchange must admit and respect its obligation, and the system must be made to subserve the interests, not of the individual operator or clique of operators, but of the cotton trade. That this result may be accomplished by establishing a standard of rule and administration to which future trading must conform, or otherwise be outlawed; and by investing the strong arm of the government with the authority, and imposing upon it the duty, to see that the prescribed principles are observed and obeyed, is at once the remedy for the abuses and the salvation of this most important agency of trade. The command must be, not that "you shall not trade in future contracts;" but that "you shall not trade in future contracts through any exchange which does not conform to certain stated principles of equity and fair dealing." When the fact is appreciated that future contract trading cannot be carried on in sufficient volume to develop either the good or the bad features, unless a large number of traders are gathered together in a market; and when it is realized that such future trading market cannot be organized and the necessary facilities afforded, except through the medium of an exchange: it becomes obvious that the enforcement of the foregoing command through the regulation of exchanges, will answer the imperative

demands of the legitimate trade and traders, and will at the same time satisfy all reasonable protests against inequities in the operation of the system.

EXCHANGES RESPONSIBLE FOR SYSTEM OF OPERATION.

It being admitted that future trading to be effective either for good or bad, or to amount to enough to entitle it to notice, must be carried on through the medium of an organization or exchange; it follows that the principles upon which, and the code of rules under which, such trading is conducted in such exchanges, become the issues of prime importance.

We will not here attempt any detailed discussion of the technical rules and requirements that should govern future transactions in the exchanges. We will announce a few general principles, which should and must be observed, and then we shall show in as plain a manner as possible how in some instances these principles have been disregarded. In this discussion it will be necessary for us to call attention to the rules and practices of certain exchanges by name. We disclaim any prejudice or sectional animosity in our arraignment of any institution. We take the facts as we find them and draw our conclusions therefrom.

POINTS OF DISCUSSION SUMMARIZED.

For the sake of unity in the arrangement of the discussion, we will not in this article begin the enumeration of the general principles which should govern the organization of a future contract exchange and the operation of the system of future contract trading; but will devote the entire following article to the consideration of this fundamental branch of the subject.

In the meantime and in order that we may not lose the sequence of the argument, we will conclude this installment with the following summary.

Ist. Future contract trading utilizes an important economic principle which is essential and indispensable to the modern cotton trade. The proper operation of the future contract agency supplies protection for all dealers in cotton, from the producers of the raw material to the ultimate distributors of the manufactured goods and makes possible the elimination of the element of speculation from the transactions of each; thus increasing the number of markets and buyers for the raw material and encouraging and extending the cotton manufacturing industry, and thereby stimulating competition in both the buying of the raw material and the selling of the manufactured product, with the result that the farmer receives more for his product and the consumer pays less for the clothes he wears. Interference with this protective principle reverses, *pro tanto,* the foregoing consummation; while the prohibition of the use of the principle would precipitate disorder and demoralization in modern business methods, and bring wholesale injury upon all concerned with the cotton industry.

2nd. In the utilization of this principle, injurious developments are evident. (a) The opportunity which future contract trading offers for speculation may be abused, and men who have no business in the speculative market may gamble to their own hurt, and men who have a legitimate use for the facility may run into a course of reckless hazard. (b) Particular systems under which the principle is operated may be faulty and may be so organized and so operated as not only to impair the usefulness of the agency, but make it, at times, an instrument of oppression to those whom logically it should benefit, and in instances, a disturbing and injurious element in the actual cotton trade.

3rd. As the evil mentioned under sub-head (a) may attach itself to any system of future trading, no matter how fair the *modus operandi* might be, the remedy therefor lies primarily in the regulation of the conduct of the individual by the state. This regulation has been applied by several states by means of anti-future trading laws, which although unnecessarily drastic, are

effective for the purpose mentioned; and which, inasmuch as they have not destroyed the future markets themselves, and have not in fact prevented the legitimate use of the contract, although in terms prohibiting the same, have not been followed by the disastrous results which by universal application and logical enforcement they would entail.

4th. As the evil mentioned under sub-head (b) is the result of a faulty system of utilizing the future trading principle, and as the systems, by means of which the principle is utilized, are formulated by the several exchanges in which such trading is systematized, the remedy for injurious developments in this regard, lies in establishing certain principles to which the exchanges must conform if they permit future trading under the rules thereof; and in order that conformity to these principles may be enforced, Federal Supervision of the operation of such exchanges, should be invoked.

CHAPTER X.

Fundamental Principles Which Should Govern Exchanges.

We have reached the point in our discussion where the onus of proper or improper utilization of the future trading principle is placed fairly and squarely upon the Exchanges which formulate the systems under which the same is made operative. Such exchanges have it within their power to enforce fair and equitable methods, or they can employ a code of rules and practice, unjust, inequitable and partisan. Whether they do the one thing or the other will determine whether future trading will realize the full benefit of its mission, or will be distorted into a questionable, if not positively injurious, agency. It is not only our duty, but we are urged by the demands of self-interest, to see that the exchanges follow the proper course in this regard.

To some who have been unwilling or unable to devote the necessary time and thought to the solution of this problem, it has seemed that the best way to prevent the future contract exchanges from employing wrongful methods and practices is to destroy them all. It must be admitted that some excuse for this disposition towards summary prohibition and reprisal is supplied by the arrogant and contemptuous attitude of one of the exchanges of this country. It is difficult to submit with patience to the intolerance of an institution which treats with indifference the just complaints of the producers and consumers of cotton and which flouts the disinterested criticism of the government itself. But summary vengeance against all future contract exchanges because of the attitude of one, is a course not only unjust in principle, but productive of unfortunate results. A fly on a man's head is an unwelcome and pestilential visitant, but it would be a monumental error of judgment to undertake to mash it with a spiked club. The welfare of the cotton

trade and of all who are dependent thereon is too important and too vital an issue to be jeopardized because we are angry, or because we do not want to take the trouble to think. To the end that we may solve the problem rationally, and with the view of securing a net return of good from our reformatory efforts, we must give some study to the question; we must ascertain what an exchange ought to be and what it ought to avoid being; and then we will be qualified to regulate these instrumentalities of trade by an intelligent and effective ultimatum.

OBLIGATION OF EXCHANGES TO THE PUBLIC.

There was a time when private corporations, and other organizations of individuals joined together for specific benefits and profits, assumed the attitude, and effectively maintained it too, that so long as they did not come into collision with the laws of the land they were at liberty to use their organized power for their own profit and in utter disregard of the interest, welfare, and rights of all others not associated or affiliated with them. In other words, it was assumed that one of the franchises of corporate existence was the right to prey upon the public. This theory of relation, repugnant alike to our organic law and to the spirit of the people, and subversive of both economic and political liberty, has in recent times been challenged by a fierce denial. The people are now awake and will not tolerate the assumption of sovereignty by the creatures of their clemency. These bodies corporate or artificial persons invested with extraordinary power, are facing a very real arraignment for the misuse of this power; and it is an over-bold advocate or else a fatuous one, who will now defend corporate selfishness upon the theory of corporate right.

Every corporation, whether it be a body chartered under law, or an association of individuals without special legislative warrant, is, either by express authorization or by sufferance, the creature of the body politic permitting it to exist and operate. Such corpora-

tion or association has no rights or powers which the people did not give it; and hence, has no warrant either in morals or in law, to use these rights or powers for the oppression of any of the people who conferred them. Any denial, therefore, by any of these institutions, of obligations to deal fairly with the whole body politic and with all the members who constitute the same, is an untenable and punishable assumption. The defense that rights have become vested, will not in such case avail, because the practice of brigandage, no matter how long continued, cannot, among a free people, ever become a vested right.

OBLIGATIONS OF COMMODITY EXCHANGES.

The foregoing generalizations apply with peculiar force to the so-called commodity associations or exchanges, and especially to those institutions of this class which deal with the products used to feed and clothe mankind. These institutions, although not organized and operated for stock profit or for the purpose of declaring money dividends to shareholders or members, nevertheless confer distinct privileges and considerable advantages upon those who participate in membership. Furthermore, the transactions conducted upon these exchanges and under the sanction of their rules and regulations, affect not only the interest of the members thereof, but the welfare of millions of people who have no membership therein, and no voice in the framing of the code of laws and practice by which the said transactions are governed. The purchases and sales consummated in such exchanges by members thereof for their own account and as agents for outside principals, establish the market value of the commodity which is the subject of such transactions; and the morals of such exchange, whether equitable and wise or unfair and partisan, is instrumental in determining the whole state of the trade. It, therefore, becomes obvious that the test of the usefulness of such exchange, and even of its right to exist, is whether or not it fully recognizes its obliga-

tion and responsbility to the public, and whether or not it makes considerate application of the powerful and comprehensive forces of which it is custodian or trustee, to the interest and welfare of all who are touched thereby.

When note is taken of the fact that the subject matter of the transactions mentioned, constitute the necessary things of life, and that the integrity of these transactions involve the sustenance and protection of the whole family of human beings, the sense of obligation contended for acquires a solemn emphasis, and the denial thereof presupposes not only a disposition and intention to profit at the expense of the unprotected and the unwary, but a callous disregard of the demand of public spirit and humanity. Commodity exchanges perform a most important function and indeed constitute a necessity with which the trade could not without irretrievable loss dispense. They should, therefore, be protected and their usefulness encouraged; but whether or not a particular commodity exchange should be protected and encouraged or assailed and condemned, depends upon the fundamental consideration of whether it recognizes its relation and obligation to the public or denies the same. Founded upon the disposition first mentioned it is a potent and comprehensive agency for good and its code of rules and practice will be consistent with its basic principle and consequently in accord with all interests affected thereby; based upon the other principle the institution is unsound at its core and is logically the breeding place of the wrongful practices which will be hereinafter specified and discussed.

CHAPTER XI.

Discussion of the Rules Under Which Future Contract Trading Is Conducted.

It must be admitted that all exchanges, and particularly all commodity exchanges, lie under imperative obligation to employ their forces of organization in the *interests of trade,* as contradistinguished from the *interests of cliques or individuals;* and not only to recognize the rights of all who are concerned with the commodity which is the subject of the transactions in such exchanges, but to use their trade machinery for the protection of such rights. From this admission must be deduced the ultimatum, that upon the full recognition of this obligation, and upon the faithful performance of the duties entailed thereby, rests the claim of such exchanges to the virtue of usefulness, and even to the right of existence.

These propostions are self-evident and trite. To announce them is to state what every thoughtful mind has already accepted as truth. We realize that no argument is necessary to establish these obvious principles; we have emphasized them for a collateral purpose. The point is not so much to verify these principles, as to emphasize the fundamental importance of a recognition of the same. We have called pointed attention to the right principle in order that we may specify in logical detail the concrete good results which follow consistence therewith, and the evil consequences that are entailed by departure therefrom. An exchange founded upon a full recognition of this obligation will naturally and logically enact laws, rules and regulations fair to all concerned: an exchange based upon the contrary principle will naturally and logically construct and operate its machinery to the end that the few shall be benefitted at the expense of the many. "A good tree cannot bring forth evil fruit, neither can a corrupt tree bring forth good fruit."

Having established the general test of moral responsibility by

which all exchanges must be tried and judged, it is now in order to give some special consideration to the instrumentalities through which these institutions make their purposes effective—namely, the rules and regulations prescribing and governing the transactions consummated therein.

When we begin to study the machinery or the system of trading employed by the future-cotton-contract exchanges, logically the first subject for consideration is the future contract itself, with special reference to the terms and conditions thereof.

THE TERMS OF THE FUTURE CONTRACT.

If the future contract is to be a *bona fide* trade agency, and if it is to perform its protective office, which is its most important function, it must not only be *fair and just to both of the parties thereto,* but it must *not hold any lurking peril, or any pitfall into which the unwary or the uninitiated trader may stumble.*

It is eacy enough to anounce these general principles, but when it becomes necessary to formulate the specific contract which will answer these requirements, the task is not so simple as a good many disputants suppose. The proposition is a complex one and cannot be disposed of by the summary and off-hand dictum of the uninformed. What constitutes a fair contract as between buyer and seller, must be determined by another test than that of mathematical division; and the safety, dependableness and utility of the contract, depends upon other consideration than the mere enforceability of its terms. We will briefly discuss these propositions separately, in the hope that certain prevalent misapprehensions may be corrected, and that an intelligent basis may be established for corrective measures.

FAIR ALIKE TO BUYER AND SELLER.

The future contracts used in the two American exchanges are not objectionable in *form* or *terms,* but are, on the contrary, in these respects substantially correct. In the discussions of this

subject, a good deal of stress has been laid upon the fact that the said contracts contain the *seller's option,* or in other words, provide that the seller has the privilege of delivering whatever grades he desires—within certain specified limits; and furthermore has the option of delivering on any day he determines—within the limits of the month and after reasonable notice. It has been contended that these options give the seller an unfair advantage over the buyer and that the latter should have at least an equal privilege with the seller in both of the above-mentioned respects.

This argument has some superficial merit, but an analysis of the relative undertakings of the parties to the contract, will show it to be unsound. The postulate that the division of privilege between the two parties should be equal, would be correct, *provided,* that the obligations and risks assumed by the two parties were equal. But where the undertaking of one party involves greater risk of danger and loss than is involved by the undertaking of the other party, it would be manifestly unfair to enforce an equal division of privilege.

That the selling party in a future contract undertakes the more onerous obligation, and that the performance of his part of the contract entails more hazard and is more subject to vicissitudes than is involved in the buyer's commitment, is obvious. The seller undertakes to deliver cotton (which he may yet have to purchase) at some future time, or else suffer severe penalties. The grades he will find available at the time his contract matures will depend upon the character of the crop and of the stocks from which he must draw his supply; and the time during the month, at which he will make delivery, depends upon the vicissitudes of transportation and other considerations over which he has no control; whereas, the buyer has only to provide himself with the means wherewith to pay for the deliveries. If, therefore, the buyer had the right to demand the delivery of specific grades on even a part of the contract, he could call for those grades which he had reason

to believe the seller did not have, or could not procure, and thus force the latter into a breach of contract and the consequent penalty and loss. Or, if the buyer had the right to select the time, or the day during the month, at or on which delivery, in whole or in part, must be made, he might, by his knowledge of the seller's situation, select a particular time at which it would be inconvenient, or impossible for the latter to make delivery. In such case, the delay of even a few days, caused by a railroad wreck or congestion, or some similar happening, might be the means of imposing a penalty and loss upon the seller, which loss neither party contemplated when the contract was made. If, therefore, the terms of the contract obliged the seller to assume the risks aforesaid, and gave the buyer, in instances, the opportunity to penalize the former by reason of accidental causes; one of two results would follow—either the seller would not contract at all, or else he would demand that the buyer pay him a premium for the unequal risk which the former assumed; and in either case the volume of future trading would be diminished to such an extent, and the price of the contract would be so affected by artificial considerations, that its utility as a hedge for non-speculative producers and merchants would be destroyed.

RELATIVE VALUE OF CONTRACTS AND SPOTS.

In this connection, it would be well to say a word about the relative value of future contracts and spot cotton. It is a fundamental prerequisite of a good contract that it should in all respects be representative of the commodity for which it stands, and that its value should be on a substantial parity with the value of cotton in the spot market. But it is a mistake to compare, as many do, the *present* value of cotton with the price of a future contract maturing in *another or a distant month.* It is error, therefore, to say that a future contract is bad and unresponsive because, for instance, spot cotton presently sold in July is materially higher than the quotations for the October contract: just as it would be

a mistake to condemn a contract because the price of spots in October, say, was lower than the future contract quotations for the following month of July. The comparison must be made between the value of spot cotton and the value of the future contract maturing in the current month. The quotations for the future months do not represent the value of cotton at the present time, but they record the consensus of opinion as to what spot cotton will be worth at said future time. But it is essential that the value of the contract maturing in the current month shall be substantially the same as the value of spot cotton. If the quotations for the contract should be materially or consistently lower or higher than the value of spot cotton, then it is proof that the contract has some defect which artificially advances its value above, or artificially depresses its value below its true, *bona fide* value as a cotton contract. Thus it becomes clear, as heretofore stated, that any terms or conditions in a contract which give it either a fictitious premium, or which impose upon it an artificial discount, will always impair, and, if of sufficient moment, will inevitably destroy the usefulness of the contract as a trade utility or a hedge.

It, therefore, follows that a contract is not necessarily unfair because it gives the seller some latitude in the option of the time during the month at which delivery shall be made; nor, as shall be shown in more detail hereafter, because it gives him an election as to the grades of cotton he will deliver, *provided,* always, that the time option shall be reasonable, and that the grade option shall be limited to cotton that is neither too low, nor too high, and to such grades as are, in normal times, salable and the actual subject of current market transactions. On the contrary, this latitude given the seller is necessary for that free and unrestricted issue and transfer of contracts which makes the future market, and supplies the spot trader with the protection which can be afforded only by the existence of such market. The "seller's option," as prescribed in the future contract, is not *per se* unfair, but is correct and

necessary. The valid objection is not that the option given is inequitable or wrong, but that under certain rules of certain Exchanges, the seller is permitted to abuse this privilege and to impose such collateral burdens upon the buyer as will discourage the latter from receiving the cotton on contract, and, in consequence, depreciate the price of such contract below the value of the cotton it represents.

In the succeeding article we will endeavor to show the necessity of a basis contract, or a contract in which the seller is permitted to deliver all merchantable grades within certain limits and restrictions. Having demonstrated the necessity of these several privileges, we will then proceed to show how they may be abused, and how they are abused; and how a contract altogether fair in its terms may be, and is, made the instrument of injurious and corrupt practices.

CHAPTER XII.

Further Discussion of the Rules Under Which Future Contract Trading Is Conducted.

In the preceding article we undertook to lay down certain fundamental rules which should be observed in the formulation of all contracts for future delivery. We announced that the contract, in its terms, must be fair alike to both buyer and seller, and must not hold any lurking dangers or pitfalls into which the uninitiated or unwary trader may fall. We undertook to show that the *"sellers' option"* as to the date (during the month) on which delivery should be made, and as to the grades (within certain limits) that should be delivered, was not only a fair provision—provided it was fairly employed—but a necessary provision, if the contract was to realize the requirement that it hold no lurking peril or pitfall. The seller, undertaking as he does the more onerous and dangerous obligation, must be given a reasonable latitude as to the time of delivery, and a reasonable election as to the grades he will deliver; otherwise he may be made the victim of an accident or a "squeeze." In this event, the selling of a future contract would be attended with such uncertainties and dangers that few would be found willing to undertake the obligation at all, or unless they were paid a considerable premium for so doing. In either case the hedging value of the future contract would be destroyed, its most important function would be impaired, and the very object of its existence defeated.

THE BASIS' CONTRACT.

Some superficial critics of the form of future contracts presently employed in the several exchanges, have found fault with the fact that they are all *"basis"* contracts, and not contracts for a specific grade or grades. A little reflection will show that the basis con-

tract—provided that the range of deliverable grades is not too wide, and provided always that the terms of the contract are justly and without partiality enforced under the rules and by the practice of the exchange—is not only fair to both parties and dangerous to neither, but is in fact the only kind of contract under which any comprehensive system of hedging is feasible or even possible.

The basis contract is a contract wherein the seller agrees to deliver, and the buyer to receive, a certain amount of cotton to be paid for at a certain price for a basis or standard grade, with additions to such price or deductions therefrom for such cotton as may be delivered of a higher or lower grade than the basis or standard. In cotton future contracts the basis is the *Middling* grade. The contracts in use in the several exchanges provide that any grade from Good Ordinary to Fair, inclusive, is deliverable. If it should so happen that only Middling cotton was delivered on the contract, then the buyer would pay therefor the price named in the contract; but if other grades than Middling were delivered, the payment for such grades would be made on the basis of so much above or so much below the contract price—the amount of the premium or discount being determined by the relative difference in value between the grades delivered and Middling, or the basis grade. To illustrate:

Suppose *A* bought and *B* sold 100 bales of cotton for October delivery at the price of 12c per pound. When October came, if only Middling cotton was tendered, then *A* would pay *B* for the total number of pounds delivered at the rate of 12c per pound. It makes no difference what cotton might be worth when October came, the settlement of the transaction would be on the price named in the contract. But suppose, instead of delivering all Middling, *B* should deliver say 50 bales of Middling, 25 bales of Low Middling and 25 bales of Good Middling. For all the Middling *A* would pay 12c, but for the Low Middling he would pay as much less than 12c as Low Middling was worth less than

Middling; and for the Good Middling he would pay as much more than 12c as Good Middling was worth more than Middling. It would make no difference what the current price of cotton might be at the time of delivery—Middling might be 15c or it might be 10c, and the other grades correspondingly high or low—the parties to the contract in the illustration would settle on the basis of 12c for Middling, with additions to or deductions from said price for the other grades delivered, as stated.

SOUND IN THEORY.

The theory of the Middling basis contract is unassailable, and it is entirely possible to give it a practical effect which is fair, just and satisfactory to all *bona fide* traders therein. If the receiver is required to take only merchantable or saleable grades, and if for the grades other than Middling he is required to pay on the basis of the *actual* difference in value between such grades and Middling that exists in the spot market at the time of delivery, he can suffer no hardship because of the delivery of such grades or because of the basis contract. But it is also possible to make the basis contract an instrument of oppression and injury. This result may be accomplished by the operation of rules and practices of the exchange permitting the seller to deliver, and compelling the buyer to receive, cotton for which there is no market and which the buyer cannot dispose of except at a loss; and by giving the merchantable grades other than the basis grade a fictitious and incorrect valuation, thus requiring the receiver in the contract to pay for such grades more than their actual relative value. These deliveries of unmerchantable cotton and this improper valuation of the grades other than the basis grade are prolific sources of manipulation of the contract price, and have done more than any other causes to bring reproach upon the system of future contract trading. A little later we will show specifically how these objectionable practices work, how the improper valuation is fixed, how

manipulation results, and how the market is affected by such manipulation. Our present purpose is to show that the basis contract correctly administered, is not only the proper medium for future trading, but is the only form of contract upon which an adequate and efficient system of future trading can be predicated.

BASIS CONTRACT NECESSARY.

This series of articles has been written in vain if it has not been made clear that the primary and essential value of the system of future trading lies in the protection and facility it affords to those dealers in cotton who cannot afford to speculate or who do not want to speculate. The major function of the system is to provide the means whereby the owner or holder of cotton, or the prospective owner or holder thereof, may hedge his holdings or commitments. The important office of the future contract is not so much to provide the spinner with the specific grades which he spins into cloth, as it is to give him an insurance that when he needs the actual specific grades, the net cost thereof will not be more than a certain stated price. The value of the future contract to the producer lies not so much in the fact that through actual delivery thereon he will find a market for his crop, as in the fact that by using the contract he can insure to himself a stated net return for his crop and not take the chance of a decline before he can get it ready for market. The great use of the future contract to the buyer and exporter is not so much that it is a source of supply of actual cotton or specific grades, nor the medium of distribution of the same, as it is that it gives him an insurance which will enable him to buy the farmer's cotton without having previously placed the same, and to contract with the spinner for the specific grades the latter will need, even though he, the buyer or exporter, has not the cotton in hand. The fundamental advantage of future contract trading is, therefore, the insurance or hedge *protection*, just as the value of an insurance policy is the *protec-*

tion it affords the insured. The enforceable specific performance of the terms of the future contract is the guaranty of this protection, just as the enforceable performance of the contract of insurance is the guaranty of the protection which the insured has bought. To compel a man to take or make actual delivery on a future contract regardless of any and all circumstances or else go to jail, as is proposed by certain legislative acts now pending, would be the same in principle as to compel a man to burn his house and thus enforce specific performance of his insurance contract, or else make affidavit that he intended to burn it, before he could validate his policy and purge himself of the presumptive charge that his transaction was gambling.

VOLUME OF CONTRACTS MUST BE SUPPLIED.

In order that there may be a supply of such contracts from which producers, buyers, exporters and spinners may purchase the required protection, it is necessary that there shall be parties who are willing to offer to sell or buy, or in other words, to issue these contracts. As heretofore shown, the supply of contracts comes primarily from the speculative class. This division of trade is composed of individuals who on the one side believe that prices will be lower in the future, and on the other that they will be higher. The first mentioned parties offer to sell, and the second offer to buy. The producer, spinner, and spot dealer who desire to protect their holdings or commitments, as heretofore shown, procure their supply of contracts from the trading center established for this purpose in the exchanges, and in turn become parties to such contracts, and obligate themselves to perform the terms thereof so long as they remain parties thereto. This speculative nucleus, reinforced and augmented by the hedge trading mentioned, constitutes the future contract market.

Now in order that there may be contracts available for those who want to buy, it is an obvious prerequisite that there must be

parties who are willing to sell. A man of ordinary judgment will not contract an obligation unless he has reasonable assurance that he can fulfill it, and he would not contract to deliver cotton at some future time if, by the terms of the contract he was, upon pains and penalties, compelled to supply the grade of the buyer's selection or any grade which he might have difficulty in procuring, or not be able to procure at all.

There has been a good deal of discussion in this connection as to the advisability of narrowing the range of grades deliverable on the contract, or of making the contract call for specific grades, or for no grade below Middling. Such stipulations in the contract would not only fail to advance the price of actual cotton, but would make the contract highly speculative, restrict its use to speculators only and would most probably destroy the future market and deprive all traders of the hedging facility. It is entirely possible to *formulate* a contract that would be most attractive to the buyer, but such contract would do the buyer no good unless he could find some one willing to assume the selling side of the obligation. Just as a person desiring insurance can concoct a policy which would be very much to his liking, but he could realize no benefit therefrom unless he could find some one who would underwrite the risk on the terms proposed. It would do no good to sanction such policy by statutory enactment. Neither Legislature nor Congress can compel a man to engage in a business or assume a risk which is objectionable to his business judgment. He would simply let it alone.

SELLER MUST NOT BE TRAPPED.

Let us see why the basis Middling contract is essential, and why a specific grade contract, or a contract on which only high grades could be delivered, would deter sellers to the extent of so narrowing the market and reducing the supply of contracts that the hedging protection, so necessary to the cotton trade, would be abrogated.

For illustration let us take in the first instance the producer who is the primary seller of cotton. The farmer does not make a crop all of one grade, neither is his crop always of a high grade. The protection desired by him is for his crop and not for one particular grade in that crop, nor for certain high grades of which he may have little or none. Suppose the producer was satisfied with the future price of cotton as shown by contract quotations, and desired to insure himself that he would realize that price and avoid the chance of a decline pending the time his crop was ready for market. He would in such case sell a contract to deliver so much cotton as he expected to make or desired to hedge. Under the currently used basis contract he could deliver all the cotton he made, except such as was very low and of an unmerchantable character. But suppose the contract he sold provided that he could deliver only one grade, or certain specified high grades. When the time came for him to make delivery, he might find that he could deliver only a small proportion of his crop, and possibly none at all. In such case such contract would not be an asset but a liability; and not only would the seller fail to secure the protection for which he had bargained, but would be penalized and "squeezed" or mulcted by the buyer in addition. One or two such experiences would effectually eliminate the producer or primary seller from the market, and would in all probability bring swift legislative action against any such contract.

But it may be contended that the producer does not use the contract market for hedging purposes to any great extent, and that the elimination of him therefrom would have no appreciable effect upon the volume of trading. Opposed to this contention it can be stated that a considerable number of planters do use the future market directly for this purpose; but even if they did not so use it at all, the effect would be the same. If the farmers do not use the future contract directly, still it is used by the merchant and buyer who purchase from the farmer, and thus the latter realizes the

benefit resulting from the future contract hedge, even though he does not personally handle the contract.

The foregoing illustration is typical. The same experience falling to the lot of the merchant or cotton buyer who sold a contract would deter them from repeating the transaction, as effectually as in the case of the producer who sold directly and suffered the consequences noted. The same conclusion is true in the case of the speculative element. The speculator is not looking for the worst of it in any particular, and, no matter how strong his conviction might be that prices would decline, he would not enter into an obligation which would require him to do something which he might not be able to do, and thus not only suffer a penalty for such default, but place it within the power of the speculative buyer on the other side of the contract to "squeeze" and mulct him.

BUYER MUST BE PROTECTED.

It, therefore, seems to be a reasonably correct conclusion that in order that the future market shall be broad enough to supply the required protection, and safe enough to warrant the use of the same, the contract prescribed should give the seller a reasonable option both as to the time of delivery and the grades that he will deliver. But on the other hand, the buyer must be protected from any misuse or abuse of this option in either respect, and from any hardships or burdens which would cause him to be mulcted and deter him from buying the contract, or having bought it, would make him unduly eager to sell it out before maturity in order that he might escape taking delivery of the cotton and avoid losses that would be entailed thereby.

The present contracts in force in the New Orleans Cotton Exchange and the New York Cotton Exchange are *in form* as nearly correct as reason and experience can instruct. Both are Middling basis contracts, both stipulate that the deliverable grades shall be from Good Ordinary to Fair inclusive, and both give the seller a reasonable option as to the time he will tender and the

grades he will deliver. No evil lies in the form of the contract. Both of the aforementioned options, however, may be abused by the seller, and, unfortunately, are so abused when permitted by the rules of an exchange and abetted by the administration and officials thereof. It is this practice by one of the exchanges in this country that constitutes the most serious count in the indictment of future trading, and it is the arrogant refusal of such exchange to adapt its rules to the principles of equity that is responsible for the animus of the contemporary attacks upon a beneficial economic system which such exchange misuses. In the succeeding articles we shall endeavor to show just how an exchange may and how the exchange in question does prostitute its function and its power by converting a contract ostensibly fair in terms and conditions into an uneconomic and predatory agency.

CHAPTER XIII.

Abuse of the Basis Middling Contract in Future Trading.

Although the basis Middling contract giving the seller the option as to the grades he will deliver and the time he will make delivery—as limited and explained in the preceding papers—is the only form of contract that will supply the protection required by the cotton trade; yet the very provisions mentioned render the future contract peculiarly susceptible to misuse and abuse, and if these provisions are not fairly interpreted and enforced, may to a great extent nullify the usefulness of the contract and vitiate the entire system of trading therein. It is, therefore, of the utmost importance that the exchanges in which such contract is the subject of trade, should safeguard the same, and by precept and practice protect the traders and the trade from an unfair and dishonest use of these necessary provisions and options.

The particulars in which this form of contract may be abused are obvious. In the first place, the grade standards adopted by the exchange, upon which standard contracts are settled, may not be true standards but misrepresentations; not *bona fide* standards but specially prepared paraphernalia; not clean cards but a marked deck: in which case the entire foundation of the contract is wrong; the trader therein is misled and mulcted and the future contract based thereon vitiated and degraded. Secondly, where several grades may be delivered on a contract, and the grades other than the basis grade must be settled for at the relative difference in the value of said grades above or below the basis, these grade differences may be, by the rules of an exchange, incorrectly or improperly fixed: in which case one of the parties to the contract liquidated by delivery must suffer a loss similar in principle to having his pocket picked; and furthermore, the contract based upon such

incorrect or improper grade differences loses its relation to the commodity it is supposed to represent, and becomes the instrument of manipulation, if not actual fraud. Thirdly, an exchange may, by its rules, permit the seller to abuse his option as to deliveries, and, by such abuse, to harass and put onerous, unjust and unequal burdens and charges upon the other party to the contract; in which case, not only is the party receiving cotton under the contract the victim of wrong, but he is deterred from using the contract as the medium of actual transfer and the latter becomes thereby depreciated and debased. Each and all of these abuses may be prevented by requiring the future contract exchange, both in rules and practice, to observe the principles of good faith in the establishment of its grade standards; of accuracy in the adjustment of grade differences; and of impartiality in the treatment accorded both parties to the contract.

We will discuss these abuses seriatim, going into some detail as to the nature and effect thereof, and finally suggesting the remedies therefor.

I. GRADE STANDARDS.

The grade standards upon which contract settlements are based should be established and employed in good faith. By this we mean that the standards adopted by an exchange should be fairly responsive to the ideas of the trade, and should moreover be known, or easily susceptible of being known, to all men who trade in the contract based thereon.

The range of grades deliverable on the contracts of the two future contract exchanges of this country is from Good Ordinary on the low end of the classification scale to Fair on the high. We have heretofore made the statement that no fault is to be found with this range of contract grades. This statement is true, provided that we know what the exchange means by its classifications, and provided further that these classifications agree with a

uniform standard representing the consensus of opinion among traders in actual cotton as to proper grade types. For instance, we might say that Good Ordinary is an entirely merchantable and spinnable grade, having in mind a sample of cotton containing a certain amount of leaf or extraneous matter. But we would retract our assertion if we found that the Good Ordinary standard of a particular exchange consisted of a type much lower than the one we had in contemplation. In order, therefore, that the trader may know that he will not be required to take delivery of unsalable and depreciated stuff, he must know that the lowest tenderable grade is no lower than a certain uniform standard with which he is familiar. Again: When the term Middling is used, the average trader sees in his mind's eye a certain grade, containing a certain amount of leaf or extraneous matter; and so on with all the other grades. When such trader buys or sells a contract he thinks he knows what kind of cotton he will have to receive or deliver for Middling, Low Middling and so on, and bases his calculations upon such assumption. If, however, when delivery is made, he finds that the grade standards of the exchange in which his contract is settled, is different from his idea of grades, his calculations are upset and thrown awry. He may, perhaps, find that such standards are lower than he expected, and, consequently, if he was the buyer he would have to pay the contract deliverer more than he had anticipated. Suppose he bought a Middling basis contract for 10c per pound: he would be willing to pay 10c for what he thought was Middling, and would be willing to pay the proper premium or discount for such other grades above or below Middling as might be delivered. But if when the cotton was tendered he found that he would have to pay 10c per pound for cotton which the exchange on its standard *called* Middling, but which in his own estimation and in the general estimation of the trade was lower than Middling, he would be called upon to stand a loss on the contract delivery which was unexpected and unwarranted.

Assuming, for the sake of argument, that the grade standards of a future contract exchange were afflicted with the vices mentioned, what would be the result upon the trader and the trade? A man who had been required to take on a contract, a grade which the exchange called Good Ordinary, for instance, but which he found he could not dispose of as Good Ordinary in the actual spot markets, and probably could not dispose of at all except at a ruinous discount; or a man who had been required to take up and pay for as Middling, Low Middling, etc., grades lower than the standards prevailing in actual spot markets, would do one of two things: either he would not buy the contract at all again, or, if the exigencies of his business required him to do so, he would bid enough less for the contract to offset the loss he knew he would make if he took delivery, and, moreover, he would be so anxious to avoid taking delivery and making the loss that he would sell out the contract at a sacrifice rather than liquidate it by taking the cotton. The inevitable effect of such defective standardization of grades would be to depreciate the contract of the exchange employing the same, below the value of actual cotton; and the consequence of such depreciation would be not only to rob such contract of its legitimate trade utility, but to constitute it in the hands of interested and powerful operators the effective means of preying upon the unwary.

IMPORTANCE OF UNIFORM STANDARDS.

It now becomes apparent why fair grade standards, and standards well known to contract traders, are necessary to the integrity of the future contract. There should be no hesitation or equivocation in this regard. The exchange that proposes to do a legitimate future business cannot do otherwise than adopt *bona fide* grade standards upon which its contracts are liquidated. It is not fair, neither is it honest to set a trap for the uninitiated and unsuspecting trader in contracts. The exchange pretending

to conduct a legitimate business in contracts cannot consistently evade the demand that its grade standards be fairly representative of the consensus of trade opinion. The first thing an exchange, intending to deal honestly, would do, would be to adopt fair standards, and then promulgate the same in order that all traders in its contracts should be fully apprised of what they might be permitted to deliver and what they would be required to receive. Any exchange which uses low and misleading grade standards and furthermore keeps the same under cover or makes it difficult for the trade to know what said standards are; and any exchange which refuses to adopt a uniform, widely-known and generally-approved standard of grade, but persists in using its own private standards for the liquidation of contracts entered into by the general trade, cannot defend its attitude upon any other ground except that its primary object is to enable its members to make money, and that by pursuing such course it places an advantage in the hands of the initiated by means of which they may prey upon the outsider.

GOVERNMENT STANDARDS.

The United States Department of Agriculture, pursuant to instructions from Congress, has taken cognizance of this important issue and has prepared, adopted and promulgated a set of grade standards from Good Ordinary to Middling Fair. These types were selected by the Department with the advice and assistance of cotton-grading experts drawn from all branches of the spot cotton trade. These standards not only represent the best opinion of the trade as to what the several grades should be, but they are widely known and any man or institution desiring to do so may at a small cost purchase a set of the same. The man who sells or buys a contract in an exchange which has adopted these standards, knows exactly what he may deliver and what he will receive for Middling and all the other grades when delivery on the contract is made. Consequently, a contract based upon these standards is representa-

tive of actual cotton and not a flim-flam device employed for mulcting the unwary.

THE REMEDY FOR FALSE STANDARDS.

The remedy for this injurious phase of future contract trading is obvious and simple. In the interest of honesty and fair dealing, as well as for the purpose of preserving and perfecting a proper and beneficial system of future trading, the Government should by law compel the future contract exchanges to adopt the grade standards promulgated by the Department of Agriculture, or else suffer the penalty of having the future contracts entered into under the administration of such non-conforming exchange prohibited and outlawed.

CHAPTER XIV.

Abuse of Basis Middling Contract in Future Trading.

(Continued.)

Continuing the discussion begun in the last article, concerning the misuses and abuses to which the basis future contract is subject, we will in this, devote some attention to the second general particular in which these untoward incidents are manifest—namely, the incorrect and improper adjustment of the difference in value between the basis grade and the several other grades deliverable on contracts.

II. GRADE DIFFERENCES.

We come now to one of the most important, and at the same time, one of the most complex phases of the future contract. The complexity is, however, more seeming than real. There is a perfectly natural, just and correct method of establishing the grade differences in contract settlements, and there is another method which is faulty, inequitable and artificial. Where the one method is used, both the receiver and the deliverer in a contract secures a fair deal, and the contract maintains its proper relation to spot cotton, and is a fair representative thereof; where the other method is employed one of the parties to the contract secures an unfair advantage over the other, and the contract loses its representative character and becomes, not the medium for the transfer of actual cotton, but an agency for speculative manipulation.

It is well within the limits of accurate statement to say that the strongest and best supported ground of the complaint against future trading, and of the antagonism thereto,

is founded upon this particular abuse of a fundamentally legitimate and beneficial system. Men have observed the erratic and unrelated fluctuations in the value of contracts which are liquidated under the unfair and uneconomic method mentioned; have become incensed by reason of the losses inflicted thereby; and have deplored the effect upon the value of the commodity supposed to be represented by such contracts, produced by the manipulation thereof; and have rushed to the unwarranted conclusion that *all* future trading was bad. Many men who have interested themselves in the question have failed to perceive that the results of which they complain are not the natural consequences of future trading, but the products of a subversion of the system, accomplished through an artificial and incorrect method of establishing the grade differences upon which the contract is settled. They have failed to appreciate that the fault does not lie in the *system of future trading per se,* but in *the rules and regulations of the Exchange* which permits and enforces uneconomic and unfair methods of settlement. And finally, they make the mistake of demanding the prohibition of all future contract trading, when the appropriate and efficient remedy lies in compelling the Exchanges to rectify the bad rule and to employ the proper method. If we understand clearly the proper and the improper methods of establishing these grade differences, we will perceive plainly where the evil lies and be able confidently to apply the specific remedy.

SYSTEMS OF ESTABLISHING GRADE DIFFERENCES.

The basis contract, as heretofore explained, is a contract upon which any of several grades, within certain prescribed limits, may be delivered; and settlement for the grades other than the basis grade is predicated upon the difference in value between the grade or grades delivered, and the basis

grade. Suppose a man buys 100 bales of cotton for future delivery on a basis contract, and pays therefore 10 cents per pound. When the delivery month arrives, suppose the seller tenders a lot of 100 bales containing several different grades. The receiver will pay for all the Middling, or basis grade, the stipulated price of 10 cents per pound, and will pay as much more or less than 10 cents per pound, for the other grades delivered as such grades are worth more or less than Middling. This is the theory of the basis Middling contract, and it is equitable and sound. The essential point, however, is that the receiver shall pay the *relative worth* of the grades delivered, or in other words, that the grade differences upon which settlement is made shall be actual and correct differences. For instance, if one of the grades delivered should be low Middling, and if low Middling should be actually worth on the market one cent per pound less than Middling, then the receiver should pay for the low Middling one cent per pound less than the contract price, or in the instant case 9 cents per pound, and so on with the other grades, either above or below Middling, delivered. If, however, in such case, the receiver is required by an arbitrary rule of the Exchange to pay for the low Middling delivered only one-half cent per pound less than the contract price, or 9 1-2 cents in the illustrative case, when as a matter of fact low Middling, in the actual market at the time, was worth one cent per pound less than Middling, or 9 cents, then the injustice of such a rule is obvious, and it is easily understandable why the purchaser in such contract should be anxious to avoid taking actual delivery thereon and be willing to sell out his contract at a discount, in order that he might escape such delivery with its inevitable loss.

The foregoing explanation and illustration leads us logically to the consideration of the two prevailing methods of

establishing the basis of settlements for grades other than Middling, when the same are delivered on the basis Middling contract. The method first indicated, or that method under which the receiver pays for the grades other than the basis, the actual premium or discount for such grades in the current market, is called the *"Commercial Difference" System;* and the other method, or that method under which the receiver may be called upon to pay incorrect and artificial differences for such grades delivered, is called the *"Fixed Difference" System.* There has been a good deal of controversy waged over the merits and demerits of these respective systems, although, in truth, there is small ground for debate. The first mentioned is the natural, economic and just method of adjustment of grade differences; while the latter is an artificial, arbitrary and inequitable device for separating people from their money. That these characterizations are true, we shall demonstrate before we have concluded this discussion; but if any of our readers should still be unconvinced and should require the testimony of some higher authority than the **Union Guide**, we refer such readers to the Report of Hon. Herbert Knox Smith, Comissioner of Corporations, United States Department of Commerce and Labor, to which report we have heretofore called attention.

"COMMERCIAL" DIFFERENCES.

The "commercial" difference system, which is employed in the New Orleans Cotton Exchange, makes contract deliveries fair to both receiver and deliverer. Under this system and the rules effectuating the same, when a future contract is liquidated by delivery, a board of disinterested expert classers inspects and grades the cotton tendered. All bales outside of the limits of tenderable grades are rejected. The classers furnish a certificate showing the grade (based on

the United States Government Standards) of each and every bale delivered, according to the marks of said bales. Reference is then had to the spot quotation board of the Exchange, which board shows daily the value of each and every grade as established by actual sales in the spot market. The difference between the value of the several grades, so found to exist, is applied to the several grades delivered on the contract. Thus if it should be found that Low Middling was actually worth in the market 1c per pound less than Middling, then the receiver would pay the deliverer for all Low Middling delivered just 1c per pound less than the contract price, and so on with all the other grades. The state of the actual current market establishes the grade differences in all instances and in every respect. The certificate of grade issued by the New Orleans Cotton Exchange shows the grade of each particular bale and identifies each bale by a specific mark or number. The correctness of such classification is guaranteed by ample financial responsibility. If the cotton covered by said certificate is redelivered on contract, it is not reclassed, but the grade or grades thereof stand as certified. The relative difference in the value of said grades, however, do not remain inflexible, but is established, as in the first instance, by reference to the spot market quotations existing at the time of such second, or any subsequent delivery.

The fairness of a contract settled upon the foregoing terms is obvious, and the desirability thereof as a medium for the transfer of actual cotton commends it to all informed traders. The deliverer need have no fear that he will be paid a greater discount or a less premium for the grades he delivers below or above Middling, than the same are worth, because he knows that settlement will be made upon the same differences that would obtain if he sold and delivered his cotton in the spot market. The receiver will have no fear of

a transaction under such contract and settlement, because he knows that he will pay the same premiums and discounts for the higher and lower grades delivered that he would pay if he bought the same in the spot market at hand. The assurance of safety in such deliveries is still further apparent in this: that although the receiver may be a merchant or a spinner requiring certain grades, and although it is true that on a contract delivery he may receive some other grades than those for which he has use, still he can receive such grades without fear because he knows that he will pay therefor the premiums and discounts that **actually exist** at the time, and, consequently, can dispose of such grades in the spot market at the same relative differences that he paid.

This fair and logical method of settlement of the basis contract not only gives it value as a medium for the transfer of cotton from seller to buyer, but invests the contract with a character for stability, safety and responsiveness which makes it what it is intended to be—the respresentative of spot cotton and the *bona fide* agency for the great volume of important and necessary hedge transactions. Furthermore, and coincident with the character just named, it will be observed that contracts based upon the "Commercial" difference method will normally maintain an approximate parity with the value of spot cotton and will not show those ruinous discounts under the value of spots which is occasionally exhibited in the case of contracts settled upon the basis of the other, or "Fixed" difference system.

"FIXED" DIFFERENCES.

The "fixed" difference system of establishing the relative value of grades, other than the basis grade, delivered on the basis contract, employed by the New York Cotton Exchange, is not fair either to the buyer or seller, or to the commodity which is the

subject of the contract. In theory the system is unfair to both parties and to the thing, but as the system is at times operated by said Exchange, the burden invariably falls upon one party to the contract—namely, the buyer or receiver, and upon the commodity which is the alleged subject of the transaction.

Under this system, the several grades other than the basis grade, delivered on contract, are not settled for upon the actual difference in value that may obtain at the time, but upon certain arbitrarily assumed differences in value fixed by a committee of the Exchange prior, and possibly long prior, to the time of the delivery. On the second Monday in September a committee of the New York Exchange meets and decides that each of the grades below Middling are worth respectively so many points less than Middling, and each of the grades above Middling are worth respectively so many points more than Middling. These differences, so fixed, remain unchanged and unchangeable until the third Monday in November, when the committee meets again and either reaffirms the differences already fixed, or establishes a new scale. The differences established at the November meeting of the committee remain unchanged, and, regardless of variations in the actual market differences, unchangeable until the following September meeting.

Under this system the differences may not be correctly fixed at either the September or November meeting of the committee, and it is, therefore, entirely possible that a fictitious valuation may be given certain low and undesirable grades, which valuation will maintain throughout the entire year and constantly depreciate the contract and exert an injurious influence upon the price of cotton itself. But even if these differences were correctly fixed in the original instances, there is no assurance that they will not be out of line almost immediately, or at any time thereafter. The

relative value of the several grades of cotton does not always remain the same; on the contrary, this value may and does fluctuate with the relative supply of, and demand for the several grades. In a year when the weather conditions during the gathering season are good, the proportion of higher grades will be larger, and of lower grades less; hence, the lower grades will be worth relatively more and the higher grades relatively less, or in other words, the difference between the lower grades and Middling, and the difference between the higher grades and Middling will be narrowed. Or, if the contrary conditions should prevail, and the open crop be exposed to rains and storms and other damaging factors, the proportion of the lower grades would be greater, and of the higher grades less; hence the grades below the basis would sell at a greater discount and the higher grades at a greater premium than in the other case.

The "fixed" difference system takes no account of the natural and inevitable variations in grade premiums and discounts. It assumes, for instance, that if low Middling is in November worth fifty points less than Middling, it will continue to be worth exactly fifty points less than Middling, until the following September. This assumption is absurdly false in theory, and in actual experience is flatly contradicted. Indeed, in recent years we have seen a disparity of a full cent per pound between the actual selling price of certain low grades in the markets of the South and the relative value of such grades fixed by the New York Cotton Exchange. In which case the buyer or receiver on a contract of said Exchange would, by the rules thereof and the fixed differences adopted thereby, be required to pay for such grades on the basis of one cent per pound higher than he could sell them for in any market in the world.

The effects of such incorrect differences or fictitious val-

uation are obvious. If the low and undesirable grades are thus favored, such grades will inevitably be attracted for delivery on the contract liquidated on such differences. If the buyer of such a contract is not previously advised of this differential against him, he is, when he takes delivery, plainly buncoed. If he is advised that in the event he takes delivery he will be required to pay such fictitious valuation on such grades, he will also be certain that the deliverer will tender such artificially valued cotton. He would, therefore, figure how much he would lose if he took delivery and paid the fictitious fixed difference, and would bid the resultant price for the contract. Depreciation of the value of the contract is the inevitable result of such conditions, and the extent of the depreciation would be measured by the amount of the loss which the receiver would sustain by reason of such injurious method of settling differences.

The practical results of "fixed" differences and of the disparity between the value of the contracts liquidated thereon and the value of spot cotton, caused by the employment of this obnoxious system, is to discourage bona fide deliveries in the course of trade, by making the buyer of such contract shun actual delivery as he would the attentions of a highwayman. Having lost its character as the representative of cotton in the market, and having been robbed of its utility as a trade agency for the **bona fide** transfer of stock, such contract, so administered, becomes the haven for the flotsam and jetsam of the cotton crop, and, in the hands of so-called "specialists," the means whereby the owner of cotton is wronged and the bona fide hedge trader despoiled.

It may be, and is, claimed that the "fixed" differences are not always incorrect, but, on the contrary are in the majority of seasons in substantial correspondence with actual differences. It is unnecessary to even deny this claim.

Admitting this contention merely for the sake of argument, the system of "fixed" differences remains indefensible. The fact that such differences *may* be incorrectly fixed, and *may* be thrown out of line at any time during any season, afflicts the whole system with unsoundness, just as one rotten link will destroy the integrity of the whole chain.

THE REMEDY.

The "fixed" difference system is indefensible except upon the theory that the function of the Exchange employing the same is to make money for the members thereof, or a certain dominant division of such membership, at the expense of the outsider, of the commodity and of the general trade. "Fixed" differences are likely to be incorrect, and incorrect differences that cannot be corrected, constitute an economic crime. The system should be summarily abated.

It should be borne in mind that this injurious incident of future contract trading does not inhere in the system itself, but is a defect of administration. A legitimate, meritorious and indispensable business principle may be, by inequitable practices, prostituted to unworthy purposes. The remedy in such case is not to prohibit the utilization of the principle, but to outlaw the prostitution thereof. The "fixed" difference method of settling contract deliveries is not only unsound in theory, but harmful in practice; and the prohibition thereof should be demanded both as a matter of abstract right, and as the means whereby the integrity of a legitimate system of future trading may be preserved.

The remedy is simple and effective. It is disclosed in the scriptural admonition "if thy right eye offend thee, pluck it out and cast it from thee." Congress may effect the required prohibition by a law denying the instrumentalities of interstate commerce to parties who trade in contracts based

upon this condemned system, and may protect and perfect a proper system of future trading by an enactment that all future contracts not based upon the equitable and approved system of operation in this particular, should be included within the said prohibition.

CHAPTER XV.

Abuses of Basis Middling Contract in Future Trading.

(Concluded)

Having pointed out how the basis contract may be misused and abused in the particular of depreciated and misleading private grade standards, and in the particular of artificial, arbitrary and incorrect fixed grade differences, we will now discuss the third general item of injurious usage to which such contract is subject—namely, the imposition, by the rules of an Exchange, of unfair and onerous charges and burdens upon the buyer who takes delivery of cotton.

III. RULES IMPOSING UNJUST BURDENS UPON THE RECEIVER.

It is inadvisable, within the limits of this discussion, to undertake recommendations as to all the rules which an deliveries. Our conclusions must, therefore, be in the nature of general principles, with an illustration of a flagrant violation of the rule of fairness for which we are contending. We shall furthermore show the effect of the improper usage complained of on the contract contaminated thereby, and shall finally make some suggestions as to remedy.

It has been heretofore shown that in order that the future contract may be a medium for the actual transfer of cotton and not a highly speculative device; and in order that such contract may be broad and elastic enough to warrant the seller in incurring the obligation without fear of an ambuscade or "squeeze"; and in order, finally, as a corollary to the two foregoing propositions, that the volume of contracts available be sufficiently large and the contract market sufficiently comprehensive to supply the non-speculative

trader with quick and adequate hedge protection; it is necessary that the contract should cover all the merchantable and spinnable grades grown by the producer, (within a certain reasonable range) and should give the seller or deliverer an option as to which of said grades he would deliver.

But if the exercise of this option by the seller is to be attended by no injurious consequences, it is imperative that the rules of the Exchange regulating the same, should be scrupulously fair both in the letter of the law and in the spirit of its enforcement. The harmful effects of the adoption by an Exchange of depreciated and misleading secret grade standards; and the injurious results of a system of contract settlement based upon artificial, arbitrary and incorrect fixed grade differences, fall logically within the purview of the pronouncements in this text against unfairness in the rules and regulations of an Exchange. But in addition to these fundamental considerations, there are certain inequities of detail applying in one of the Exchanges of this country, which impose such burdens upon the receiver in the contract, that he will, in order to avoid delivery, sell out his contract even at a considerable discount under the value of cotton in spot markets. We will cite one glaring instance of this discrimination against the buyer or receiver in the future contract.

IMPROPER CERTIFICATION.

The rules of the New York Cotton Exchange require that before cotton is tendered on a contract, it must have been examined by its classification department and a certificate issued showing the several grades in the lot. Delivery of the cotton is made by the passing of this certificate, together with the warehouse receipt covering the lot, from the deliverer to the receiver. This process is entirely correct, as far as it goes, but under the said rules, it does not go far enough.

The certificate of grade does not give sufficient information. It is true that the certificate shows that a certain number of bales grade Middling, and a certain number Good Middling, Low Middling and so on, as the case may be, but it does not apprise the receiver by any means of identification, which particular bales are Middling, Low Middling, Good Middling, etc. If the receiver upon inspection of his grade certificate finds that there are in the lot a certain number of bales of the particular grades he can use—if he is a spinner—or which he can place,—if he is a spot merchant—and he further finds that there are other bales of grades which he cannot use or presently dispose of and which he desires to re-tender upon contract, he is unable to ascertain from the face of the certificate which are the particular bales he wishes to segregate, but is put to the necessity of having the whole lot turned out and sampled; and furthermore his certificate is by this proceeding cancelled, and if he desires to re-tender any of the cotton on contract, he is required to submit the same to the Exchange for re-inspection, reclassification and re-certification—all of which entails an added trouble and an extra expense, not called for by any requirement of trade but altogether gratuitous and wanton.

By way of illustration suppose the receiver is a spinner who requires for his mill cotton grading Strict Middling to Good Middling. Suppose his certificate calls for 500 bales and he finds noted that there are 200 bales than he can use for his particular wants. Naturally, he would desire to withdraw these 200 bales from warehouse and ship the same to his mill, and the remaining 300 bales he would want to re-tender on a contract. Under the said New York Cotton Exchange rule he would, in order to accomplish this result, be obliged to go to the trouble and expense of having the entire lot of 500 bales turned out and re-sampled. He would

select the said two hundred bales therefrom, and in order that he might re-tender the 300 bales remaining, he would be compelled to re-submit the same to the classification committee of the Exchange, to be by it re-inspected, re-sampled and re-certificated.

There is no good reason why the certificate in question should not supply the receiver with the information which would enable him to take cotton on contract and dispose of it to advantage. On the contrary, there is every reason why these details should be supplied, if the framers of the contract and rules governing the same, intend in good faith that the contract shall be a trade utility and not a cover for some ulterior purpose. If after having made a contract of sale, the seller in any contract, attempts to block delivery by throwing obstacles in the way of the buyer, the presumption is well nigh conclusive that the seller is not anxious to consummate the transaction according to the terms of the contract, but rather the buyer shall compromise, or settle in some other way more advantageous to the seller. When an Exchange regulates the performance of its authorized contracts by rules and regulations which give the seller the advantage noted and which gratuitously impose said burdens upon the buyer, the presumption is conclusive that the framers of such contract and such rules desire and intend that the contract be not liquidated by actual delivery, but that the buyer should be frightened off and induced to get rid of his contract upon the best terms he can secure from the seller. Indeed it would seem that the Exchange employing such methods, instead of desiring to facilitate bona fide deliveries on contract, was determined to prevent such deliveries; and as a motive for such attitude it may with a considerable degree of justice be surmised that said Exchange was afraid that unhampered delivery on contract might be made the

means of depriving a so-called market of its artificially accumulated stock of cotton; and in order to prevent this catastrophe devised the rule in question as well as the others noted, to discourage buyers from demanding cotton, which under the terms of the contract they had every legal and moral right to do.

PROPER CERTIFICATION.

In order to emphasize the injustice of the certification rule just criticised and the ulterior significance thereof, let us examine the proposition from the other side and consider the fairness and the beneficial results of a proper system of certification.

The New Orleans Cotton Exchange, as has been heretofore stated, furnishes the receiver of cotton on contract, with a certificate showing the grades of cotton contained in the lot delivered. So far the rules of the two Exchanges coincide, but there is a material and significant difference between the two certificates. The New York certificate gives the number of bales of each grade, but does not identify the bales with their respective grades. The New Orleans certificate, on the contrary, shows on its face every bale in the lot, identified by marks or numbers, and opposite said marks or numbers the grade of each bale is specified. Thus the receiver, upon the mere inspection of his certificate, knows the character of his entire purchase and is able to segregate the same according to the dictates of his interest or engagements. Furthermore, after he has withdrawn from the certificate such cotton as he desires to use or ship, the Exchange will, without cost to the holder and without any more formalities than a request, issue a new certificate for the residue.

An exporter or spot merchant who supplies the mills, may, for example, take actual delivery on a future contract

when it matures. Under a proper system of certification, when he inspects his certificate he will find that there are a certain number of bales of a given grade which he can sell to a given trade or to a particular mill. With his certificate before him he will order out of warehouse these particular bales by marks or numbers and ship them to his customer. He will find certain other grades he can sell to certain other mills or trade, and these he will order out in the same manner. He may thus dispose of the entire lot received without leaving his desk and with no more labor and expense than is involved in writing out the necessary orders on the warehouse. Or, if there is any residue that he cannot place, all he has to do is to make the request, and the Exchange will give him a new certificate for such residue, with each bale classed and its grade accurately identified therewith, as in the first instance, without any cost whatsoever.

This rule of certification is in its terms and in its object fair and logical, and not only encourages producers, merchants and spinners to use the contract as a medium of transfer, distribution and supply, but by its honest and equitable treatment of both buyer and seller, tends to make the contract a representative of the commodity, and not the subservient agent of a clique of individuals who make their money by divorcing the contract from the alleged subject matter thereof and subjecting it to the vagaries of manipulation.

The impairment of the hedge value of the future contract—which is, as heretofore stated, its most vital and comprehensive function—effected through the abuse herein specified, together with the abuses heretofore set out, is now obvious. If the future contract is to be a *hedge,* it must stand in the place of the cotton covered thereby, or in other words, be its representative, and not an independent agent subject to influences and variations to which the commodity itself is

not subject. The party requiring a hedge may not take or make delivery of the cotton covered by the future contract, but if he is to have an adequate and *bona fide* hedge, he must be assured of protection and fair treatment in the event that he does take or make delivery. It makes no difference how many different parties may have and use a contract during its currency, some parties will have to liquidate it at maturity. The rules governing deliveries and settlements, therefore, give the character to a contract throughout its entire life. A future contract which is by the rules of delivery and settlement deprived of its representative and responsive character, does not, and cannot supply a legitimate hedge. It, therefore, follows that such a rule as the one complained of herein, is not only unfair to individuals, but is subversive of the fundamental merits and legitimate functions of future contract trading.

THE REMEDY.

The remedy for this particular abuse of the basis future contract and of the seller's option thereunder, does not appear to be so direct and specific as the remedies in the two aforementioned cases. If a cotton exchange, either because of the exigencies of its location or necessities, or from a wilful disregard of its semi-public character and its obligations to all branches of the trade it is supposed to serve, sees fit by its rules and regulations to utilize its machinery for partisan and private ends, it is not a simple matter to directly circumvent such design. All the details of administration cannot be specifically regulated, because it would be impracticable for the law-making power to frame a set of rules for the government of all the business details of an Exchange. But the case is by no means hopeless. There are certain definite and essential principles which may be enforced, and made operative for the proper working of the system. In the first place, the

compulsory adoption by the Future Contract Exchanges of the National Grade Standards and of the "Commercial Difference" system of establishing the relative value of the several grades in deliveries, would place the future trading system upon sound fundamentals; and regulation in these vital respects would not only prevent the abuses complained of, but would by logical compulsion bring about the adoption of detail rules consistent with such fundamentals. In the second place, an act of Congress commanding the observance by the Exchanges of certain cardinal principles of regulation and management, would consistently carry a provision charging some department of the government with supervision with respect to the proper observance of the said mandatory pronouncements. An act framed for intelligent application to the obvious abuses practiced under the name of future contract trading, with the supplemental safeguard of supervision by a department of the Federal government, would without doubt minimize, if it did not entirely eradicate the injurious incidents of future trading, add to the usefulness of the Exchange, and preserve to the cotton trade that indispensable protection which can be afforded by future contract trading, and by that agency only.

RE-STATEMENT OF ABUSES.

Having in the last three papers directed attention to the fundamental abuses to which an adequate and workable future contract is subject—which abuses constitute, in fact, the basis of the complaints that are recklessly made against the whole system of future trading—we will, in order that attention may be concentrated upon the salient points of the argument herein made, bring this part of the discussion to a conclusion with a concise re-statement of the evils that militate against the system which we are endeavoring to explain and

which, when properly administered, we are determined to defend.

Grade standards upon which contract settlements are made, if too low, or if not in accord with the views of the trade; and if in addition, such standards are held for the information of the favored few and not accessible to the trading public, open the door for fraud: and even if there should be no fraudulent intent or action, the use of such standards renders the specific performance of the terms of the contract by acceptance of delivery thereon, a hazardous and injurious undertaking, and thus undermines the *bona fides* of the future contract and perverts its character as an agency of trade.

"Fixed" grade differences, in the first place give those who "fix" them, the power to invest certain grades comprising a minute proportion of the crop, with a fictitious value when tendered on contract, thereby crucifying the buyer or receiver; and by the same act divorcing the contract from its proper relation to spot cotton, and making it the subject of unrelated manipulative fluctuations: and in the second place, even though the differences are not deliberately fixed for the purposes mentioned, still if such differences are fixed and inflxible, the natural variations in the relations of supply and demand, may at any time bring about the harmful conditions stated.

Insufficient and incomplete grade certificates, and other phases of discrimination against the buyer or receiver on contract, cannot be designed for any other purpose than to discourage such buyer or receiver from demanding or taking the cotton on his contract, and to induce him to get rid of his obligation at a discount to the end that interested sellers might buy in their shorts at a profit. Such practices are not only not indefensible in principle, but in practical effect they mulct the bona fide user of the contract, and assist in depre-

ciating the value of both the contract and the commodity, and in defeating the legitimate ultimate purpose of the former—namely, the transfer of actual cotton by the final holders thereof.

NOT PARTISAN OR SECTIONAL.

It is no part of our purpose to make war upon any institution *per se.* We have deduced certain principles which apply to all cotton exchanges wherever domiciled and under whatever name they may be called. If it so happens that the rules, regulations or practices of a particular Exchange are in conflict with these generalizations, then we think that such Exchange, by name, is the legitimate subject of criticism. Our object is to promote a better understanding of the issue of future trading, to the end that the admitted evils may be eradicated without the necessity of destroying or impairing the good. The importance of the issue in both of its branches, justifies us in speaking plainly of the offenders as well as of the offence.

The New York Cotton Exchange offends flagrantly, insistently and arrogantly in the three particulars stated. This institution maintains these cardinal irregularities in contemptuous disregard of the demands of both the producing and manufacturing divisions of the cotton trade for a fair and responsive contract, and in open defiance of the strictures of Commissioner Herbert Knox Smith of the Bureau of Corporations.

These conditions should and must be changed. Not by any vindictive legislation aimed at the New York Exchange, nor by any wholesale prohibition of future contract trading. The direct and effective method is to establish certain standards of trading to which the future contract exchanges must conform. If they do not or can not conform, it is their

fault or misfortune. By analyzing the system and its abuses we have endeavored to lead up to the point of outlining a concrete plan for improvement. Legislation is needed, but we must be very sure that our efforts in this regard shall be intelligent, discriminating and constructive; not haphazard, vindictive or destructive. We will devote a next succeeding article to a discussion of the latter, or hurtful, modes of reformation, and in the article following thereafter, we will bring the series to a close with certain suggestions for legislation along what we believe to be sane and constructive lines.

CHAPTER XVI.

Future Contract Trading:. Summary of Uses, Abuses, Remedies.

The series of articles on Future Contract Trading, which has been running in the **Union Guide,** will, as stated in our last issue, be brought to a conclusion with a discussion of the pending and proposed legislation relating to the subject. If we have properly diagnosed the trouble, the next important step is to find the appropriate remedy. A physician may be accurate in his conclusions as to the nature of his patient's malady, and yet through a want of care and thorough attention, may administer the wrong remedy and kill the patient. In an effort to avoid this fell conclusion, we will re-state the case in as concise a form as possible, to the end that our minds may firmly grasp the essentials of the subject before we undertake the important and dangerous task of formulating the efficient remedy.

LEGISLATION ENACTED AND PENDING.

In recent years a great hue and cry has been raised against trading in contracts for the future delivery of cotton. All of the Southern States, with the exception of two, have enacted laws, more or less drastic, directed against such trading. Organized future trading is carried on in the New Orleans Cotton Exchange and the New York Cotton Exchange. Neither the State of Louisiana nor the State of New York has adopted anti-future trading laws, hence it is still possible to buy and sell future contracts in said Exchanges. The said state anti-future laws have not in fact prevented the citizens of said states, who are engaged in the cotton business and for

whose business future trading is a necessity, from buying and selling for future delivery, but these laws do to a great extent actually prevent such trading by parties who have no use for the future contract other than as a medium for speculation. But the anti-future advocates are not satisfied with what has been accomplished, and have been and are now attempting, through Federal legislation, to prohibit all future trading, whether necessary or unnecessary, whether legitimate or otherwise, by closing up the future trading departments of the American Exchanges, and thus depriving American citizens and producers of both the right and the opportunity to trade in said contracts, and turning over to the European markets and manufacturers the uncontested privilege of shaping future prices for their own selfish interest and ends.

In this crisis it is imperative that the people of the South who are interested in the price that cotton brings and in the welfare of the cotton trade—and all the people of the South are either directly or indirectly interested in these issues—shoud proceed with caution and judgment, lest by a reckless interference with economic laws, the whole complex machinery of the cotton trade shall be thrown out of gear and the fabric of modern business issuing therefrom, come forth rent and wrecked.

FUTURE CONTRACT TRADING.

Future Contract Trading is not understood by the great majority of people, and is woefully misunderstood by the great majority of its opponents. It is an economic issue which calls for scientific and discriminating attention. It has been made a political issue and utilized as the basis of demagogic appeals to prejudice. Without any intention of defending

the abuses that have been practiced in the name of future contract trading, but with every desire, and a fixed determination, to exert our every effort to wards the eradication of such abuses, we are constrained to issue a solemn warning to the farmers of the South, that they pay greater heed to the admonitions of sane counsel than to the fustian of stump speaking.

Future Contract Trading *per se is not bad,* but is on the contrary entirely legitimate, and in the evolution of the trade has become absolutely necessary to the advantageous movement of the immense volume of the present day cotton crop. In order that the future contract should perform its full and proper function, the trading therein must be concentrated at certain given centers and systematized by certain appropriate rules and regulations. These necessary centers of operation where trading is reduced to rule and order and where buyers and sellers in person or through representatives, are brought together, thus constituting the future markets, are called future trading Exchanges. The system of trading as developed, has been, and is, productive of great fundamental benefit to all divisions of the cotton trade from the producer to the spinner and from the spinner to the ultimate consumer. But it is not to be denied, but rather charged, that in this development abuses have been engendered and injurious results entailed. Analysis will demonstrate that these abuses and results are not the logical consequences of future trading, but the fruits of inequitable rules and regulations and injurious practices in force, particularly, in one of the American Exchanges. To differentiate these incidental evils from the fundamental good and to destroy the one without harm to the other, is one of the most important, if not the paramount, economic issue before the people of the South to-day.

THE CONTRACT.

The future contract is a legal and binding obligation. Two parties, through their agents, enter into an engagement, the one to deliver and the other to receive a certain number of pounds of cotton at a stated price and at a specified time in the future. This contract, when it matures, must be liquidated either by specific performance of the terms thereof, or settled by the agreement of both the final parties thereto. The original principals to the contract, however, need not necessarily be the final holders. The obligations of the contract may be in the meantime transferred to any number of parties. This facility of transfer makes available a large volume of trading, and out of this supply, the non-speculative producer, merchant, buyer and manufacturer is able to secure his hedge, or that protection against fluctuations in price, which is as essential to any of the parties mentioned, as a policy of insurance is to the owner of any property.

PRACTICAL USES AND BENEFITS.

If the spinner can go into the future market and by buying contracts *insure* himself that he can obtain a requisite amount of cotton at a stated price when he needs it, he is in a position to contract ahead for sale of the output of his mill and thus enlarge his business for his own profit, and increase the consumption of cotton for the benefit of the producer. The more business the spinner does, the greater amount of cotton he consumes, and the more stable his business and the fewer risks he takes, the cheaper will he be able to sell his manufactured output. He can secure this protection in only one way, and that is through the future market. If this market were destroyed and the spinner deprived of his hedge, the following results are demonstrable: Because of decreased consumption the farmer would receive less for his product,

and because of the increased risk and cost of manufacture, he and all wearers and users of cotton goods would pay a higher price for their supply.

If the spot cotton buyer in the interior markets of the belt can go into the future market and by selling contracts *insure* himself that he will obtain a stated price for any spot cotton that he might buy, he is in position to make an offer on all cotton that comes to market, even though he has at the time no order from the spinners for such cotton as he might purchase. Thus an outlet is created for cotton that must be marketed, even when there is no demand from the actual users thereof or the manufacturers; and the farmer is to an extent relieved from the burden of carrying the cotton until such time as the spinner had need for it, or else of auctioning it off to bargain hunters. The buyer can secure this necessary protection or hedge, in only one way, and that is through the future market. If the facility in question were destroyed, this source of demand would be curtailed, and if the farmer was dependent upon the spinners alone to buy his cotton, he would frequently find times at which it was impossible to sell, and in any and all events he would have to carry his cotton until it suited the spinners to buy it, or else sell it at the price dictated by his adversary. The demonstrable results in such case would be the elimination of the small buyer, the concentration of the buying power into a few strong hands in combination against the farmer, the establishment of a limited number of large markets and the destruction of the multitude of smaller buying centers, the annihilation of buying competition, and in consequence of all these, an inevitable decrease in the amount the producer would receive for his crop.

PRESENT SITUATION.

In this connection attention may be profitably called to the present situation in cotton. By some unthinking or uninformed persons, the great decline during the months of September and October is charged to speculation. To the attentive observer such statement is perceived to be far from the truth. The pressure on the market causing the decline in prices has come primarily and consistently from the owner of actual cotton. It is not our purpose to criticise the farmer for his precipitation in rushing his cotton on an over-supplied and unwilling market. The excuse of necessity in some cases and of fear in others, may be urged in extenuation. But the fact remains that the farmers themselves did smother the market with offerings. Speculation was influenced by the course of current spot prices and did not lead the decline. Spot offerings broke the market and future contracts followed. That this statement is true can be proved by reference to the future contract quotations of the New Orleans Cotton Exchange and the comparative spot prices, especially in the markets of the eastern part of the belt.

But it will be asked, if our contention be true that the future market affords an outlet for cotton that is weighing upon the market, why has not the future market absorbed the recent and current surplus of offerings and maintained prices? Our answer is that to an extent this is exactly what the future market did do. There was no human agency that could have withstood the effects of the stupendous rush of supplies to market, but if it had not been for the future market, in which buyers could hedge their purchases, these effects would have been disastrous instead of distressing. Suppose there had been no future market, and suppose, because of inability to hedge purchases for which there was no present demand,

the great multitude of buyers had been driven from the market and the producer left dependent upon the current needs and demands of the spinner, and upon these demands alone? In such case the pressure would have been infinitely grater than it was, and we would have had, not a serious decline in the price of cotton, but a panic in the cotton trade. Let those who are clamoring for the prohibition of future trading and the destruction of the future markets, ponder well this pro tective phase of the future contract, and what it means not only as an agent for stimulating an advancing market, but as a buffer to a market temporarily over-supplied and smothered by actual cotton.

Briefly, the hedge supplied by the future contract, and by that agency alone, constitutes an insurance against the risks of handling cotton, which insurance enables a multitude of buyers to compete with each other and with spinners in the purchase of the farmer's crop, and enables the spinner to conduct his business at the minimum of cost and risk to himself, and to enlarge his consumptive capacity to the great. benefit of the producers of cotton. If this protective facility should be destroyed the effect upon the value of the commodity and upon the machinery of the cotton trade, would be similar to the demoralization of general business and the shrinkage in the value of all property, that would follow the prohibition of all underwriting by insurance companies.

But in magnifying the importance and necessity of future contract trading we must not lose sight of the evils that have grown out of the sytem under which such trading has been in instances operated. If we are under obligation to preserve and utilize the beneficial functions, we are no less constrained to prohibit and destroy the injurious features thereof.

EVILS OF FUTURE TRADING.

The obvious evils which future contract trading has developed, may be designated under two general heads, viz.: *Excessive Speculation, and Manipulation of Prices by Means of Unfair Rules and Practices in the Exchange.* Blame for the first mentioned injurious development falls primarily upon the individuals who misuse and abuse the contract facility; reprehension for the second named, must be directed toward the Exchange which formulates the rules and permits the practices complained of.

EXCESSIVE SPECULATION.

The great wave of speculation which swept the country a few years ago and which was to a great extent responsible for the crusade against future trading, had one important phase of manifestation which has been erroneously charged against contract trading and cotton exchanges. This phase was what is called "Bucket-Shopping." A large proportion of the said results of the speculative mania is properly attributable to the indefensible practice named. Bucket Shops are not Cotton Exchanges, nor is "bucket-shopping" trading in future contracts. The bucket shop is a gambling institution pure and simple, and its proprietors bet with their customers upon the fluctuations that occur in the value of actual contracts, as registered by actual trades made in legitimate cotton exchanges. There is as much sense in attempting to destroy bucket-shopping by prohibiting future contract trading, as there would be in an effort to stop betting on horse races by killing all the horses. Inasmuch, therefore, as bucket-shopping and future contract trading are two separate and entirely distinct propositions, and in further consideration of the fact that bucket-shopping has been practically destroyed by legislation in the several Southern States, and can

be rooted up and cast out forever by other legislative acts specially directed thereat, this practice can not logically be considered as an evil for which future contract trading is responsible.

Speculation is neither wrong nor wicked, *per se;* but on the contrary gives life to all trade and vitality to all enterprise. But speculation may be abused, and when this is the case restrictive measures should be employed. Speculation by the general public, and excessive speculation, even by those who are financially able, and equipped in other respects to assume the risk entailed, constitutes an injury to the individual trader and an unhealthy and hectic element in the body economic. But as has been stated, this is the fault of the individuals who abuse the principle of speculation. The speculative principle is not only a beneficial and vital influence in trade and being such, should not be eradicated, but it is an instinct inherent in human nature, and being such, can not be eradicated. The remedy lies in regulation. To undertake to prevent the individual from abusing the principle of speculation, by attempting to destroy all opportunity to speculate, would be no less illogical than to essay the suppression of profanity in individuals, by the command that all men should remain speechless and dumb. But this evil of excessive and indiscriminate speculation, as it relates to the effect on the individual speculator, has been to a great extent taken care of by the State laws heretofore mentioned. The larger economic phase, or the effect of excessive speculation upon the commodity, and the trade therein, which is the subject of such transactions, is easily traceable to a particular future trading institution, organized for the purpose of promoting speculation, and operated under a system of rules and regulations which puts a premium upon speculative manipulation. Thus we arrive at the crux of the complaint against future contract

trading—the specific source of the contamination which has brought the whole system into reproach, namely:

MANIPULATION BY MEANS OF UNFAIR RULES AND PRACTICES IN A COTTON EXCHANGE.

A future contract Cotton Exchange, if it is to realize its proper and beneficial function, and if it is to escape condemnation as a menace and an injurious influence in the trade it purports to serve, must recognize as the fundamental basis of all its operations, its obligations to the public, or to the entire division of the public interested in the commodity which is affected by its transactions, and must not direct its activities upon the assumption that it is a private club, organized in the interest of its members, or a certain favored clique of its membership, to enable these to profit at the expense of the outsider, and of the commodity which is the ostensible subject of trade. If the Exchange is organized upon the first mentioned theory, the rules and regulations under which it operates will of logical necessity be open, fair and equitable to all concerned; if organized upon the other theory it will, in its laws and practices, make manifest its partial, unfair and inequitable purposes.

There are three fundamental particulars in which a future contract exchange may offend against the plain principle of right, mulct the uninitiated individual trader, depreciate the value of the future contract and of the commodity for which it is supposed to stand, convert a logical trade utility into a highly speculative medium, and finally, by such means, encourage speculation not of the legitimate, stimulating, beneficial type, but of the injurious, "sure thing," manipulative variety.

The first of these particulars of offense is the use by an Exchange of *grade standards,* as the basis of settlements on contract deliveries, which are depreciated, misleading and not known or accessible to the parties to the contract, unless they happen to be members of that Exchange.

The second particular mentioned, is the adoption by an Exchange of the uneconomic, inequitable and condemned system of *"fixed" grade differences* which govern in contract deliveries, and which, as has been demonstrated by disinterested testimony, not only establishes artificial values, to the detriment of the individual trader, the trade and the commodity traded in, but opens the door to actual fraud.

The third particular is exemplified in *rules imposing unequal burdens upon the buyer or receiver on a contract,* thereby penalizing the latter for demanding and taking delivery of cotton thereon, discouraging him from so doing, depreciating the value of both the contract and the commodity, and encouraging speculation on one side of the market—namely the short side. The most conspicuous example of such rules is the imperfect system of grade certification heretofore explained.

THE CURE.

This is the case against future contract trading. It will be readily perceived that the untoward developments in the system are not inherent in the system but are the results of specific acts of misuse and abuse. The basis of the trouble can be reached without difficulty through the enactment by Congress of certain fundamental provisions to which all future contract Exchanges must conform. To be more specific: An act of Congress

(a) making compulsory the adoption by such Exchanges of the grade standards approved and promulgated by the United States Department of Agriculture;

(b) outlawing the obnoxious "fixed" difference system; and

(c) authorizing a department of government to supervise the operations of such Exchanges and report violations to the proper officers,

should effectually eradicate the evils growing out of the wrong use of the system of future trading without the necessity of destroying the system itself, and thereby bringing demoralization upon the cotton trade, and loss upon the producer of the great world-desired asset of the South.

CHAPTER XVII.

Anti-Future Legislation Pending and Proposed.

Having set forth the economic necessity for a properly regulated system of future contract trading; having laid down certain fundamental principles that should govern those Exchanges in which future trading is conducted; having pointed out certain injurious developments in the future contract system as it is operated under certain unfair rules and regulations specified; and finally, having reached the conclusion that the beneficial function of the system can be preserved and perfected and the evil developments eliminated only through regulative legislation and supervision by the Federal government, it is now in order to examine certain pending legislative efforts and to offer some concrete suggestions as to the kind and form of legislation that will produce the desired results.

DESTRUCTIVE LEGISLATION.

The first and most important consideration is that legislation on this subject should be regulative or remedial and not destructive. Those drastic anti-future measures which propose to eradicate the incidental evils by prohibiting all future contract trading would, if enacted into laws, smite the cotton trade hip and thigh, demoralize the demand for cotton and the markets therefor, and would saddle the greater share of the resultant loss upon the man who ultimately pays the penalty for wildcat economic legislation—namely, the producer. No less disastrous would be the effects of legislation, although in terms not absolutely prohibitive

and although according to the professions of proponents, merely regulative, which being based upon an imperfect knowledge of the subject or a crude conception thereof, proposes a use of the future contract altogether impossible to honest men, and hence in logical result, prohibitive.

The acts now pending before Congress are all of the aforementioned destructive character. Typical of this sort of legislation is the Scott Bill which was introduced in the 61st Congress, amended in House Committee on Agriculture, passed by the House, amended in Senate Committee, and finally dying on the calendar upon the adjournment of Congress, March 4th last. This bill has been re-introduced by Hon. A. S. Burleson of Texas, and is now pending. As it is probable that this measure will receive consideration at the forthcoming session, it is of vast importance that its significance be fully understood. Before undertaking an analysis of the technical provisions of this bill a little introductory matter may be with profit presented, for the purpose of showing that the measure is not a great moral agent, as its proponents claim, but merely a clumsy attempt to interfere with economic customs and laws.

ALLEGED ANTI-GAMBLING MEASURES.

When the Scott bill was originally introduced back in 1909, its prohibition covered future contracts relating to grain, cotton and all other farm products. It was proclaimed by its proponents as a great moral measure which would annihilate the pernicious practice of "gambling" in farm products. As the bill fared on its way, however, the "moral" phase met with a mishap. We find that the bill, when it had finally been reduced to the form in which it passed the House, no

longer applied to grain and the other farm products, but its prohibition related to cotton contracts only. It appears that the grain farmers of the West, fully satisfied with the effective "anti-bucket-shopping" laws which their several States had enacted, and realizing the great advantage accruing to them from legitimate future contract trading, objected to the inclusion of their commodity within the prohibition of Mr. Scott's bill. It may be remarked in passing, that Congressman Scott represented a Kansas district, that—as we are informed—in the last election he made his campaign largely upon his activity in connection with his anti-future bill, and that his prosperous constituency promptly retired him and elected another Congressional representative in his stead.

But, passing these collateral considerations and returning to the main issue, the fact remains that the Scott bill in its ultimate form, and its successor, the Burleson bill in its present form, did not and does not prohibit future contracts relating to grain and the other farm products, but such contracts only as relate to cotton alone. If it is morally wrong to trade in cotton future contracts, it is morally wrong to trade in such contracts when they relate to grain or any other commodity. A man can not claim to be a good prohibitionist if while he fulminates against corn whiskey, he winks at the drinking of rye. By eliminating grain and other farm products from the prohibition of the proposed statute, its proponents have definitely abandoned the moral issue. They must quit prating about the sin of gambling and give us some economic basis for their measure and advance some argument to show why trading in cotton futures is bad for the cotton trade, while trading in grain futures is good for the grain trade. Probably they will tell us that the system of trading

in grain contracts is regulated to better advantage than is the case with the system of trading in cotton contracts. This brings the issue squarely in line with our contention that future contract trading *per se* is beneficial, but that certain incidental developments therein are injurious; and is an unequivocal admission that the remedy lies in the regulation of the system under which such trading is conducted and not in the annihilation of the future contract itself. The test by which any proposed legislation should be tried is, therefore, clearly perceivable. If a proposed law will regulate future contract trading and preserve the benefits of the same, it is good and should be enacted; if it materially impairs or destroys the facility, it is bad, and should not be passed. Does the Scott bill, and its successor the Burleson bill, fall within the one characterization or the other? We claim that this proposed legislation is destructive and not regulative; and furthermore, we insist that it would not only destroy the hedging facility and prohibit the legitimate use of the contract by self-respecting and non-speculative traders, but would actually encourage the illegitimate use of the future contract by irresponsible and unprincipled gamesters. In other words, such a law would prove to be not only futile, but pernicious.

SCOTT OR BURLESON BILL ANALYZED.

The Scott, or Burleson bill, as it is now called, is typical of the anti-future measures pending in Congress. The discussion of the provisions of this bill will, therefore, be applicable to all the others pending.

This bill in its first essential provision declares that it shall be unlawful for any person to transmit by telegraph, telephone, wireless telegraph, cable, or other means of com-

munication interstate or international, any message offering to make or enter into a contract for the purchase and sale of cotton for future delivery, without intending that such cotton shall be actually delivered or received.

Thus the lawfulness of a future contract is made to depend upon the intention of the parties thereto at the time of the making of the contract; and furthermore, it is not sufficient that the parties shall intend to receive and deliver actual cotton, but they must intend to receive or deliver the cotton embraced in the contract into which the parties have entered. In other words, under this provision, no contract for the future delivery of cotton shall be lawful unless the parties thereto shall intend under any and all circumstances that they themselves shall specifically perform the engagements of the contract. The penalty for the violation of this provision is a fine, or imprisonment, or both.

But realizing that the intention of a man, or that disposition which he holds in his secret mind, is an illusive and unprovable fact, the proponents of the bill attempt to rescue it from utter futility by making it incumbent upon the parties to a future contract to commit themselves in the matter of intention by a direct statement under oath; and in order to secure a conviction of unlawful intention upon these unhappy parties, proponents attempt to arbitrarily import a sinister significance into otherwise lawful actions.

Therefore, the second essential provision of said bill requires all parties sending a message relating to a contract for the future delivery of cotton to make an affidavit covering certain specified particulars of fact, which in effect constitutes a sworn statement that the intention of the sender of such message is to receive or deliver the cotton covered

by such contract; and it is provided, furthermore, that proof of failure to make said affidavit, or proof that the parties did not actually make or take delivery of the cotton called for in such contract, shall constitute *prima facie* evidence that there was no intention to take or make delivery of such cotton when the contract was made, and consequently that the same was unlawful. Violation of this provision is likewise punishable by fine or imprisonment, or both.

In short, under said bill, every contract for the future delivery of cotton shall be unlawful unless every successive party thereto shall intend to deliver or receive actual cotton on said contract, and unless such parties shall make affidavit covering such intention, and finally, unless each and every party thereto shall actually, and in fact, specifically perform the terms of said contract by receiving and delivering the cotton called for thereby.

WOULD DESTROY HEDGING.

The proponents of this bill claim that they do not propose to demoralize legitimate cotton business; they specially disclaim any intention of destroying the hedging function of the future contract; and they make the wholly inaccurate and illogical statement that their bill will not produce the aforementioned results, but will eliminate gambling transactions only. This claim and statement is based upon the flagrant mistake of assuming that every contract not liquidated by each successive holder thereof by actual receipt or delivery of cotton thereon is necessarily a speculative contract, when as a matter of truth and fact few of the nonspeculative hedging contracts are ever by the parties thereto liquidated by such receipt or delivery. Therefore, by forcing

each and every party to a future contract to make or take actual delivery thereon, and by thus denying to any parties to such contract the right of selling out or transferring the same to other parties, the said bill strikes at the very vitals of the principle of hedging, and would, if it should become a law, absolutely prohibit the use of this necessary facility.

The importance of the hedging function of the future contract has been heretofore emphasized, and the manner in which this protection may be secured has been fully explained. The spinner broadens his business, enlarges his requirements and increases the consumptive demand for cotton by contracting to deliver his output during long future periods; and he could not make these forward commitments unless he could protect the same by buying a hedge in the future contract market. The buyers of cotton at the thousands of points throughout the belt, supply markets for cotton even when there is no present demand from spinners therefor. But these buyers could not make and carry such purchases unless they could protect themselves against a decline in the market pending the time when they could dispose of such holdings, by selling a hedge in the future contract market.

HOW SPINNERS' AND BUYERS' HEDGES WOULD BE DESTROYED.

Under the present system of hedging, the spinner, when he enters into commitments to supply manufactured goods to the cloth merchant, protects himself by buying contracts for the raw cotton. The buyer, when he purchases cotton for which he has no order, or which he is unable at present to sell to the spinner, protects his purchases by selling contracts for future delivery. There are two future contract markets

in this country—one at New York and one at New Orleans—and one principal market abroad, at Liverpool, where hedges may be bought and sold. The contracts bought and sold under the auspices of the cotton exchanges in said markets, specifically require that the cotton covered by the contract shall be delivered and received in the respective markets and at no place else. The parties desiring the hedges are located at different points throughout the entire country. Such parties, therefore, wire or telephone their orders to brokers in one or the other of the exchanges mentioned, who execute the contract for and in behalf of their principals.

If the party in such case is a spinner, he may not, and in the great majority of cases does not, intend to take delivery in New Orleans, New York or Liverpool, but expects and intends to select such grades as he requires at the nearest market when available, or out of the most desirable stock or offers which come to hand. He desires the hedge as a matter of protection until he has bought the spot cotton, probably from some merchant in his own town, and when he has so bought he no longer needs the contract and, therefore, sells it out to some other party. If he was compelled to take delivery on the contract, he would in the first place be by no means sure that he would receive the specific grades he needed; and in the second place, he would have to pay the freight, moving and carrying charges on the cotton from its point of origin, (which might possibly be in the same county or town in which his mill was located) to New York, New Orleans or Liverpool, as the case might be, and thence back to his mill. This would be an economic absurdity.

The spot buyer in the multitude of Southern markets, under the present system of hedging, sells his contract for

future delivery either in New York, New Orleans or by a bare possibility, in Liverpool. He expects and intends to deliver actual cotton, but not in either of said markets. He expects and intends to deliver his holdings to some spinner customer, possibly near at hand, when the latter needs supplies. He wants the future contract merely as a hedge until such time as he can place his stock. When he has placed the same, he no longer needs the hedge contract and, therefore, closes it out to some other party. If he was compelled to make delivery on every such future contract into which he entered, he could not sell to the nearby spinner, but would be obliged to ship his holdings to New Orleans, New York or Liverpool, as the case might be. This, also, would be economically absurd.

But the bill in question says unequivocally that all contracts for future delivery of cotton shall be unlawful unless the parties thereto intend to make and take delivery of the actual cotton under the terms thereof and shall make affidavit of such intention, and shall in fact so deliver and receive. The spinner in Augusta, Georgia, for instance, if he bought a hedge contract in the New York Exchange would under the provisions of said bill be compelled to take delivery in New York or else he would be fined or sent to jail; and the spot merchant in Augusta, if he sold a hedge contract in New Orleans, would, likewise, under the provisions of said bill, be compelled to deliver in New Orleans or else pay a fine or be thrown into jail. Thus the spinner and merchant even in the same town, if they undertook to hedge their commitments, would, instead of dealing directly with each other, erect a Chinese wall between themselves. "Hedging" under the Scott or Burleson bill would not be a protection, but a calamity. Let no one be misled in this regard. If the Scott bill, or any act constructed upon similar lines, should

become a law, and if its provisions should be enforced, the American manufacturer and the American spot merchant would be summarily denied the vital and indispensable protection of the hedge contract. Are proponents willing to assume responsibility for such a wreckage of the machinery of modern trade?

WOULD PROHIBIT THE GOOD AND ENCOURAGE THE BAD.

But we have made the statement that not only would the bill in question destroy the beneficial and legitimate use of the future contract as a protective, or hedging agency, but it would actually encourage the pernicious gambling phase, which its proponents claim it is designed to destroy. We have shown how the said bill would destroy the one, let us now consider how it would encourage the other.

It has been shown that the provisions of the bill deprive American manufacturers and American spot merchants of the use of the future contract as a hedge; but how about the speculators? It is true that the responsible and self-respecting members of the speculative division of trade would, along with the spot merchants and spinners, refrain from laying themselves liable to a prosecution for perjury or a term in jail for failure to receive or deliver cotton called for in the contract; but how about those irresponsible and unprincipled speculators who would be more than willing to ply their trade provided they could do so without fear of being caught? Would this bill interfere with these? On the contrary, it not only would not prevent these injurious practices, but by an express provision protects those who operate therein.

The bill in question provides that a separate affidavit of intention need not be made to cover each particular transaction, but that the party can give all his transactions *prima facie* legality by swearing that he will not send any messages relating to the pro-

hibited contract within the period of six months next succeeding the date of the affidavit. If the speculator of the undesirable class mentioned undertook to execute his contract in New Orleans or New York, the federal authorities could trace these contracts and if it should be found that no cotton was delivered or received thereon, the party could be convicted under the act. But suppose the party should make the required omnibus six months affidavit of intention, and then open an office for the purpose of executing contracts on the *Liverpool Cotton Exchange. Prima facie* all the messages relating to these contracts would be lawful because of the affidavit. But suppose the contracts concerning which the messages were sent, were not lawful, but gambling ventures pure and simple. What danger would attend the sending of such messages and the operations in such contracts? True the act provides that proof of failure to receive or deliver the actual cotton would be *prima facie* evidence of the unlawfulness of the contracts. But how could this proof be obtained in the cases mentioned? The contracts were supposed to have been executed in Liverpool, and the United States authorities would be wholly without authority to compel the English broker to disclose whether or not there had been actual delivery on the contracts. Ordinarily, this difficulty might be obviated by haling the American contract trader into court, and by his books proving that there had been no actual delivery; but the act itself by specific provision makes such a proceeding futile and nugatory and confers absolute immunity upon the suspect by the following proviso: "but no person shall be prosecuted or sub-"jected to any penalty or punishment whatever for or on account "of any transaction, matter or thing concerning which he may "testify or produce evidence of any character whatever."

Thus in logical and inevitable effect, the act would not only destroy the good that is in future contract trading, but would encourage and protect the bad.

BASED UPON WRONG PRINCIPLE.

Our limited space will not permit us to go into a discussion of the specific injurious effects that would follow the enactment of the measures criticized. Enough has been said to show that the principle of the proposed legislation is wrong. It is based upon an imperfect knowledge of the subject matter of the proposed prohibition, and upon a reckless disregard of consequences, which makes it necessarily mischievous and destructive. The contrary principle should prevail. The end to be obtained should be clearly ascertained and then the appropriate and effective means to such end should be carefully selected and judiciously employed. This is a vital economic issue involving the material welfare of millions of people and the prosperity of one of the great industries of the world. Congress has no more right to single out the cotton trade to experiment thereon by the application of nostrums, or the enactment of rough-house legislation designed to satisfy the prejudice or to advance the prestige of certain of its members, than has a cotton exchange, for example, the right to enact laws and rules which will enable some of its members to prey upon the great industry and to mulct the multitude of people concerned therewith.

In the next succeeding article we will bring this series to a close with certain recommendations for legislation based upon the analysis of the subject attempted in these columns, and animated by what we apprehend to be a proper consideration for all the great interests involved.

CHAPTER XVIII.

Remedial and Regulative Legislation.

Assuming that future contract trading **per se** is not only beneficial to the cotton trade but necessary thereto; and admitting that the system under which future contract trading is presently operated is faulty in some respects and has in some instances developed drawbacks which not only militate against the efficiency of the contract as a trade agency, but which injuriously affect the market for the commodity which is the subject of the transaction, it then follows that the task before us is to devise some legislative measure which will, in the first place, establish a proper and equitable system of future contract trading; and which will, in the second place, eradicate the known evils that exist and prevent a recurrence of the same.

SUMMARY OF THE GOOD TO BE MAINTAINED AND THE EVILS TO BE ABATED.

Our investigations have disclosed that a Middling basis contract, permitting the delivery of spinnable and merchantable grades only, based upon the grade standards promulgated by the United States Government, and settled on the relative actual or commercial difference in value between the basis grade and the other grades delivered, existing in the market where the contract is made and at the time the same is liquidated, is the typically fair contract and the only contract that would or can be traded in to an extent sufficient to make it serve its economic purpose.

We have also found that the evils which have attached themselves to the system of future contract trading proceed

from two general causes: first, excessive speculation in the contract; and second, unfair and partial rules and regulations of an exchange which give certain individuals an advantage, impair the trade utility of the contract and adversely affect the value thereof. Under the head of speculation, we have endeavored to show that the harm proceeded, not from speculation **per se**, but from encouragement to speculate offered to those who were not qualified to participate therein, and from gambling wages effected in certain evil institutions known as "Bucket Shops." Under the head of unfair and partial rules and regulations of exchanges, we have found that the fundamental evil lies in the claim to irresponsibility which a certain exchange endeavors to maintain; and we have found that the particular and specific causes of harm lie in the refusal of such exchange to adopt fair and authoritative standards of classification, in the rule compelling settlement of contract deliveries to be made on the basis of fixed arbitrary and incorrect grade differences; and finally, in the imposition of burdens and hardships upon the receiver of cotton in the contract for future delivery.

Addressing ourselves to these merits and demerits, we would recommend the passage of a Federal Statute which would fix the status of a legitimate contract as pointed out, and correct and prohibit the obvious abuses thereof. The difficulty lies in differentiating the permissible and beneficial class of future contracts from the class which is bad and should be prohibited. A wholesale prohibition would result in much more harm than good, and an unintelligent tinkering with the question would prove mischievous if not destructive. The object of the exposition and analysis attempted in this series of editorials is to aid in reaching a just conclusion in this regard.

It is submitted that a bill drafted on the following lines would cover the several particulars pointed out and answer the several requirements specified.

THE PROPER BILL.

A BILL

to prohibit the use of the instrumentalities of interstate and foreign commerce, such as railroads, ships and vessels, mail, telegraph, telephone and express companies, from being used to conduct or to aid or assist in conducting interstate and foreign transactions, or interstate or foreign contracts for the purchase or sale of gambling contracts for the future delivery of cotton, and to prohibit such contracts.

SECTION 1. BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES IN CONGRESS ASSEMBLED:

That every contract, order, direction or request transmitted directly or indirectly by mail, by telegraph or by telephone, or by ship, vessel or railroad or by express or by any other means of communication from a person, firm, corporation or association in one state, or territory, or in the District of Columbia, or in any foreign country, to another person, firm, corporation, or association in another state or territory, or from any foreign country to another state or territory, or to the District of Columbia, for the purchase or sale of cotton for future delivery in or on the floor of or under the rules of any cotton exchange or association whose members, or allowed habitues, or authorized visitors, deal in

such contracts, either as brokers or as principals, or elsewhere, is hereby declared to be a transaction of interstate commerce or of commerce with foreign countries.

Sec. 2. That all such contracts, orders, directions or requests for the purchase and sale of cotton for future delivery where the intention of the parties is not to make or receive an honest and bona fide delivery of cotton, are hereby declared to be gambling transactions.

Sec. 3. That all transactions for the purchase and sale of cotton comprehended in Section 1 hereof, except as hereinafter declared and specified; and all the transactions comprehended in Section 2 hereof, are hereby prohibited and made unlawful, illegal, null and void, and the person, firm or corporation that pays any money, or gives anything of value in settlement or in payment of such prohibited contract shall have the right to recover the same in any court of the United States having jurisdiction of the receiver. This right shall be barred by the limitation of one year from the date of the payment or delivery of anything of value.

Sec. 4. Be it further enacted, etc., That it shall be unlawful for any person, firm, corporation or association to send or cause to be sent from one state or territory of the United States or the District of Columbia to any other state or territory of the United States, or the District of Columbia, or to any foreign country, by mail or by telegraph, telephone, ship, vessel, railroad or express company, or knowingly to receive or knowingly to cause to be received in any state or territory of the United States, or the District of Columbia, by mail, or by telegraph, telephone, ship, vessel, railroad or express company, any letter, telegram or message, or written or printed order relating to a contract for the future delivery of cotton such as is prohibited in this act.

Sec. 5. Be it further enacted, etc., That it shall be unlawful for any person, firm, corporation or association owning or operating any interstate or foreign telegraph, or telephone, or ship, or vessel, or railroad, or express company, or any person acting as officer, agent or employe of such owner, knowingly to use, or knowingly to allow the use of such property for the transmission from any foreign country, or from one state or territory of the United States, or from the District of Columbia, to any state or territory of the United States or the District of Columbia, or knowingly to receive, or knowingly to cause to be received in any state or territory of the United States or the District of Columbia from any other state or territory of the United States or the District of Columbia, or from any foreign country, any letter, telegram, message, or written or printed order relating to a contract for the future delivery of cotton such as is prohibited in this act.

Sec. 6. Be it further enacted, etc., That the provisions of this act shall apply to all interstate and foreign contracts for the future delivery of cotton which fall within the provisions of Section 2 of this act, no matter where or by whom executed, and shall apply to all interstate and foreign contracts for the future delivery of cotton, executed in or on or by the members of, or brokers of, or allowed habitues, or permitted visitors of all so called cotton exchanges or associations of persons, which do not expressly and clearly provide by their rules or by their by-laws as follows, and do not with proper diligence enforce such rules:

1st—That every contract to buy or sell cotton for future delivery made on its floor, or under its rules, or between its members, or between its members and third persons is an

enforceable obligation to deliver and to receive actual cotton as specified in the contract, and that any stipulation or understanding to the contrary between the parties is prohibited.

2d.—That the standards of grades adopted and established by the United States Department of Agriculture shall be the standards upon which Spot Quotations are based and future contracts settled in all exchanges situated in the United States.

3rd.—That all contracts for the sale of cotton for future delivery executed in any exchange in the United States shall be on the basis of the Middling grade of the Standards of the said Department of Agriculture, unless particular grades are by special agreement specified; and no grade below Good Ordinary and no grade above Middling Fair on the said Standards, and no unmerchantable cotton of any grade whatever shall be deliverable on said contracts.

4th.—Where cotton other than the basis grade is delivered on a future contract, the difference above or below the contract price which the receiver shall pay for such grades, shall be determined by the actual difference in value between such grades and the basis grade found to exist in the market for spot cotton where the exchange is located and at the time when the cotton is delivered and received; and no arbitrary difference in value between the several grades shall be fixed or established by or under any rule or by-law of the exchange.

5th.—Where in contract deliveries a certificate of grade is issued by the exchange, then such certificate must show upon its face the grade of each bale certificated, identifying the same by mark or number with its grade.

6th.—The reporting of false or fictitious sales, and all fraudulent conduct by a member with another member or

with a non-member shall be punished by expulsion from the exchange.

Sec. 7.—Be it further enacted, etc., That the United States Bureau of Corporations is hereby specially charged with the duty of examining from time to time, the rules, regulations and by laws of all Cotton Exchanges and associations, for the purpose of discovering whether they comply with the provisions of this Act, and it shall report the result of such examinations to the District Attorneys of the respective districts in which such exchanges or associations may be located.

Sec. 8.—Be it further enacted, etc., That any person who shall violate any of the provisions of this act shall, upon conviction thereof, be punished for each offense by a fine of not more than one thousand dollars nor less than two hundred and fifty dollars, or shall be imprisoned for not more than six months nor less than one month, or both.

Sec. 9. Be it further enacted, etc., That this act shall go into effect within ninety days from the date of its approval by the President, and that all laws and parts of laws contrary to or in conflict with the provisions of this act be and the same are hereby repealed.

SUMMARY.

This bill would make cotton future contracts executed on the floor and under the rules of the exchanges, transactions of interstate commerce and, therefore, subject to the regulative power of Congress: it would declare that all contracts for the future delivery of cotton where the parties intended not to make delivery were gambling contracts; and it would prohibit and nullify such contracts and would deny

the use of the mails and the instrumentalities of interstate commerce to these gambling transactions. Thus Bucket Shopping and kindred practices would be annihilated.

But the bill goes further: It would regulate the exchanges in which future contract business is transacted, by denying the use of the mails and instrumentalities of interstate commerce to all such transactions unless the rules of the exchange in which they were consummated provided for certain specified standards of settlement and enforced certain principles of correct method and fair dealing.

And finally, the regulative function of the proposed law is made effective by lodging in one of the departments of the Federal Government the authority to see that the mandates of the statute are observed.

If our understanding of the nature, functions and necessity of future contract trading is correct, and if our diagnosis of the faults and evils of the system, as it has been in instances operated, is true, then the proposed bill will strike at the evils only, while permitting and encouraging the beneficial and protective functions of forward trading.